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Tender Offers: Safeguards and Restraints — An Interest Analysis

Alan R. Bromberg

I. GENERAL ASPECTS OF TENDER OFFERS

A. Terminology (1.100)

LANGUAGE IS USED LOOSELY on tender offers. In this article, at least, these are the meanings of the key phrases:

(1) Tender offer — a cash or exchange offer, publicly made, by a person (usually a corporation) to acquire a large quantity of outstanding securities of a publicly held corporation.¹

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(2) Cash offer — a tender offer with all cash consideration.²

(3) Exchange offer — a tender offer with consideration consisting of securities, with or without cash in addition.³

(4) Target company — the company whose securities are sought in a tender offer.

(5) Target securities — the securities of the class(es) sought in a tender offer.

¹ This definition, and the article, excludes offers by an issuer for its own securities. The article generally assumes that the offeror has no prior relation with the target company except perhaps as a noncontrolling shareholder. This is not inherent in the definition but helps to focus the discussion.

² The most comprehensive article on cash offers is Fleischer & Mundheim, *Corporate Acquisition by Tender Offer*, 115 U. PA. L. REV. 317 (1967), in *SELECTED ARTICLES ON FEDERAL SECURITIES LAW* 815 (W. Wander & W. Grienberger, eds. 1968), and 2 *MERGERS & ACQUISITIONS* 49 (No. 4, Summer 1967). Their article precedes but partially anticipates the 1968 federal tender offer legislation. Act of July 29, 1968, 15 U.S.C. §§ 78m(d)-(e), n(d)-(f) (Supp. IV, 1969) [hereinafter referred to as the Williams Bill]. Elsewhere I have written extensively on the operative details of the Williams Bill. See A. BROMBERG, *SECURITIES LAW: FRAUD — SEC RULE 10B-5* § 6.3 (1969); Bromberg, *The Securities Law of Tender Offers*, 15 N.Y.L.F. 459 (1969) [hereinafter cited as Bromberg, *Tender Offers*], which is substantially the same as the cited portion of the book. To avoid undue repetition here, I will refer often to these sources.

³ For a further discussion on exchange offers, see Bromberg, *Exchange Offers*, 2 *REV. SEC. REG.* 805 (1969) [hereinafter cited as Bromberg, *Exchange Offers*]; 12 *CORP. PRAC. COMMENTATOR* 1 (1970).

(6) Target management — the management of the target company.

(7) Offer price — the amount of cash offered, or the trading market value of other consideration.

(8) Premium — the excess of the offer price over the trading market price of the target securities.⁴

(9) Trading market — all the markets in which the target securities are customarily bought and sold (*i.e.*, the stock exchanges on which they are listed, and the over-the-counter and third markets in which they are traded) as distinct from the total market which includes extraordinary transactions like the tender offer itself.

B. *Chronology* (1.200)

There are three fairly well defined phases in a tender offer: before, during and after. Throughout this article, we will have occasion to distinguish among them. In a simple offer, the pertinent activities are described below.

1. *Pre-Offer Period* (1.210).— The offeror studies and evaluates the target company, its securities and their holders. The offeror prepares the offer and the mechanics of dissemination. It procures financing or authority to issue securities as consideration. It complies with applicable laws and makes arrangements with dealer-managers and others who will solicit. The offeror usually, but not necessarily, contacts target company management and major holders of target securities to obtain their support.

2. *Offer Period* (1.220).— The offer is communicated and made effective; it may be republished or recirculated several times. The offeror and its solicitors try to persuade holders of target securities to tender. Brokers, who are commonly entitled to a double commission by the terms of the offer, go to work on their cus-

⁴ The premium may be measured against the trading market price at the announcement of the offer or at the beginning of the offer. These are usually simultaneous in a cash offer but may be weeks or months apart in an exchange offer because of the need for SEC registration. Unless otherwise indicated, I shall mean premium over the price at the beginning of the offer.

The premium will often be about 20 percent. See Wall Street Journal, June 30, 1965, at 8, col. 4; Hayes & Taussig, *Tactics of Cash Take-Over Bids*, 45 HARV. BUS. REV. 135, 139-40 (Mar.-Apr. 1967), note that some use 20 percent as a rule of thumb, but that the median premium of 1956-66 offers was 16 percent, with a range from zero to 44 percent. They find that premiums are proportionately larger for lower price stocks.

tomers who hold target securities. The dealer-managers may coordinate the work of the brokers (on a best efforts basis) and the solicitors, and also conduct any stabilization or other market operations that may be appropriate. Holders who choose to tender deliver their securities with prescribed transmittal forms to depositary banks designated in the offer, or to forwarding banks.

3. *Post-Offer Period* (1.230).— The depositaries tally the tenders, review their validity and determine whether any required minimum has been attained. The offeror takes up (buys) the tenders it is bound to by the offer, and any others it wishes to (if permitted by the terms of the offer). The depositaries handle the transfer of securities to the offeror, the payment of the consideration and the return of tenders not taken up.

C. *Market Pattern* (1.300)

The offer is inevitably reflected in the market for the target company's securities. The typical pattern is outlined below.

1. *Pre-Offer Period* (1.310).— Some increase in volume and price, perhaps from foothold purchases by the offeror, or from purchases by others, first on the rumor that the offer will be made, and then on the announcement (if any is made before the offer becomes effective).

2. *Offer Period* (1.320).— The offer is made at a premium above the then trading market price for the security. If the terms of the offer have not been announced in advance (which will typically be true in a cash offer) any stock exchange on which the target securities are listed may halt trading long enough for some absorption of the news. Perhaps this will be only 15 minutes. If there is a severe imbalance of buy and sell orders, the opening may be delayed longer. If the target securities are traded only over-the-counter, a similar halt might be ordered by the SEC or state authorities, although this is not common. When trading begins, it is usually at considerably higher volume than before, and the market price rises quickly toward the offer price. The market price should, in theory, equal the tender price discounted for (a) the delay in payment, (b) transaction costs, and (c) the uncertainty that the tender price will, in fact, be paid.

The buying comes largely from arbitrageurs who hope to profit by the spread between the market price and the offer price. These are usually brokers and other market professionals. The selling comes largely from holders who prefer an immediate cash sale,

at an enhanced price, to the uncertainties of the offer (if it is conditional) or of the securities offered in exchange.⁵ If it is an exchange offer, arbitrageurs may be simultaneously selling short the offered securities in a hedge against decline in value of the latter.

Tenders are ordinarily made only at the last minute before the expiration of the offer, or before the period for pro rata takeup of tenders.⁶ The hope is that a better offer will come along, or that the market price will rise above the offer price. There may also be a fear, in an exchange, that the offered securities will decline in value. There is, thus, a sizeable increase in the "float" of target company securities, sensitive to small fluctuations in price. Concomitantly there is a tendency for securities to pass from relatively long-term holders to short-term traders.

3. *Post-Offer Period* (1.330).— Volume and price of target securities usually decline, depending in part on how many, if any, tenders are taken up, and when this information is released.⁷

Market activity in the securities of the offeror is less predictable. The same premium that is intended to make the offer attractive to securityholders of the target company may seem adverse to holders of the offeror, in which case its securities may decline. Or, more commonly in markets which have usually been enthusiastic about acquisitions, the offer terms may seem favorable to the offeror, in which event its securities may rise. Even in this event, the movements are unlikely to fall as neatly into periods as the target company securities. If the offer is one of exchange, when-issued trading in the offered securities will normally begin when the offer becomes effective. This can provide an important index of value of the offer when it consists wholly or partly of securities which have not previously had a market. But it can easily be distorted by the conflicting play of stabilization buying and arbitrage short selling.

D. *Effects of a Tender Offer* (1.400)

The initial effect of a successful tender is to reduce or eliminate public ownership of the target securities, and concentrate

⁵ A securities firm's analysis of market strategies for, and reactions to, tender offers (primarily cash offers) appears in BLAIR & CO., INC., *THE STRATEGY OF TENDER SOLICITATIONS, especially at* 1-12 (1967).

⁶ See *Crane Co. v. Westinghouse Air Brake Co.*, 419 F.2d 787, 792 (2d Cir. 1969) (85 percent of tenders were made on last day of the contested exchange offer).

⁷ For statistics, see the authorities cited note 19 *infra*, second paragraph.

the ownership correspondingly in the offeror. Former security-holders of the target company now hold cash (if it is a cash offer, or if they have sold in the market) or securities of the offeror (which may differ greatly in kind and quality from those previously held, as in an exchange of subordinated debentures and warrants of a diversified company for common stock of a one-industry company). Thus, there is change of ownership of outstanding securities and changes in investment of former owners. Economic ramifications include an increase in the liquidity of investors (if it is a cash offer) and the creation of tax liabilities in many instances.

Indirect consequences are infinitely diverse. Here are some of the more important possibilities:⁸

⁸ For a further discussion, see N.Y. Times, Mar. 11, 1970, at 61, cols. 6-7; *id.* at 70, col. 3. The story reports an administrative hearing under Connecticut law, to consider the exchange offer of International Telephone & Telegraph Corporation for Hartford Fire Insurance Company. IT&T promised (1) not to cut employment in Hartford Fire, (2) to keep Hartford Fire's headquarters in the city of Hartford, (3) not to reduce pension and fringe benefits of Hartford Fire employees, (4) not to take any cash out of Hartford Fire except to pay dividends, (5) not to reduce the level of insurance in any line being written by Hartford Fire for at least 5 years, (6) not to make investments of Hartford Fire in IT&T without permission of the State Insurance Commissioner, and (7) not to interfere in the management of Hartford Fire, which would have its own board of directors with IT&T members in the minority. All these promises (most of them with time limits of 5 or 10 years) were made conditions of the Commissioner's approval of the exchange offer. International Tel. & Tel. Corp., Conn. Ins. Comm'r., Finding and Final Order, May 23, 1970, at 13. The order limited fund transfers from Hartford to IT&T (item (4) above) to annual earnings, and went on to specify that there would be no reduction in the level of Hartford's participation, financial and otherwise, in civic and charitable affairs in local cities. Finally, it provided that IT&T, as a Hartford shareholder, would use its powers to embody the conditions in Hartford's corporate charter.

An earlier application for a Hartford Fire merger in IT&T had been turned down by the Insurance Commissioner, who suggested, among other things, that an exchange offer would be fairer to minority shareholders. Hartford Fire Ins. Co.-International Tel. & Tel. Corp., Conn. Ins. Comm'r., Finding and Final Order, Dec. 13, 1969.

Ling-Temco-Vought promised that there would be no plant closings, employment cutbacks or pension fund "raids" at Jones & Laughlin when LTV took control after its tender offer. On this basis, unions at J&L dropped their opposition to a settlement of the antitrust action brought by the government, which is cited in note 143 *infra*. In approving the settlement, the court specified that LTV would not direct or suggest the investment of J&L pension funds without the consent of the Department of Justice. Wall Street Journal, June 2, 1970, at 5, col. 2; *id.* June 11, 1970, at 5, col. 1 (Southwest ed.) For another catalogue of tender offer consequences, from the antitrust viewpoint, see United States v. Northwest Indus., Inc., 301 F. Supp. 1066, 1097-1100 (N.D. Ill. 1969) (denying preliminary injunction against exchange offer, but enjoining — pending trial on the merits — numerous specific acts of control over the target company); United States v. International Tel. & Tel. Corp., 306 F. Supp. 766, 798-802 (D. Conn. 1969) (*semble*). See also Metro-Goldwyn-Mayer, Inc. v. Transamerica Corp., 303 F. Supp. 1344, 1354 (S.D.N.Y. 1969) (financing of cash offer by competitor of target company).

A recent statistical study found that 57 percent of 1956-65 tender offers were

- (1) Changes of management personnel in the target company.
- (2) Changes of business plans and operations in the target company, such as purchasing, marketing, advertising and pricing.
- (3) Changes in product mix or quality, or in employment policies of the target company.
- (4) Changes in asset and liability composition and utilization of the target company, *e.g.*, transferring assets to the offeror.
- (5) Changes in corporate form of the target company, through liquidation or merger into the parent (*i.e.*, the offeror).
- (6) Changes in capitalization and dividend policy of the target company.
- (7) Changes in the market for target securities, *e.g.*, delisting by a stock exchange because of reduced public holdings.⁹

E. *Contested Offers* (1.500)

The picture changes drastically if the offer is contested. Market reaction is less predictable, investor uncertainty greater. The prospects for success of the offer decline sharply.¹⁰

Opposition moves are directed principally at defeat of the offer by several major means: (a) discouraging securityholders from tendering, (b) discouraging arbitrageurs from buying target securities in the trading markets for the purpose of tendering, and (c) discouraging the offeror from persisting in the offer. However, the maneuvers may have side effects or aims, such as improving the offer or obtaining employment contracts or other prerequisites for target company management. All this is psychological as well as economic warfare.

The wide variety of defenses and counterattacks by the target company and its allies may include these strategies and tactics:¹¹

- (1) Fighting with words: exhortations to holders of target

followed by mergers, mostly within a few months. Austin & Fishman, *The Tender Take-Over*, 4 MERGERS & ACQUISITIONS 4, 16-19 (No. 3, May-June 1969).

⁹ For allegations of antifraud violations including coercion by the threat of delisting, which later occurred, see *Berne St. Enterprises, Inc. v. American Export Isbrandtsen, Inc.*, 289 F. Supp. 195 (S.D.N.Y. 1968).

¹⁰ Comment, *Economic Realities of Cash Tender Offers*, 20 ME. L. REV. 237, 243-47 (1968) (survey of offers involving NYSE listed companies, January-June 1967: only two of 10 contested offers succeeded; all eight uncontested offers succeeded).

¹¹ On defense maneuvers generally, see Fleischer & Mundheim, *supra* note 2, at 321-22; Hayes & Taussig, *supra* note 4, at 142-47; Schmults & Kelly, *Cash Take-Over Bids — Defense Tactics*, 23 BUS. LAW. 115 (1967); Comment, *supra* note 10, at 246, 249; Note, *Defensive Tactics Employed by Incumbent Managements in Contesting Tender Offers*, 21 STAN. L. REV. 1104 (1969); 11 CORP. PRAC. COMMENTATOR 378 (1970); Wall Street Journal, July 11, 1967, at 1, col. 6.

securities not to tender, usually featuring arguments that the offer price is inadequate, and that any offered securities are overvalued. These may be preceded by a plea not to take any action pending further study by target company management and its advisers. Other negative publicity may be aimed at brokers and analysts able to influence customers and clients.

(2) Trumping the offer by: (a) a better offer from an ally (preferably tax free in the form of a merger); (b) a counter offer by the target company; or (c) a rise in the trading market price of target securities above the offer price induced by means such as purchases of target securities by the target company and its allies, raising the dividend on target securities or splitting them, making favorable acquisitions, product or service innovations, or financial projections (or announcing any of these if time is too short for completion).

(3) Undermining the control potential of the offeror: issuing additional shares to friendly hands, or calling convertible securities or callable warrants if the common is selling high enough to assure conversion or exercise.

(4) Shifting target securities into friendly hands: trading market purchases by the target company or its allies.

(5) Impeding communication of the offer: denying the offeror the names and addresses of target securityholders and stalling any court action to obtain them.

(6) Fortifying the target company: charter or bylaw amendments to thwart an assumption of control by a major shareholder (by staggering the election of directors) or a merger with it (by increasing the necessary shareholder vote, say from two-thirds to four-fifths).

(7) Collapsing the target company: merger into a friendly ally.

(8) Impoverishing the target company: disposing of liquid funds, which may have attracted the offeror, by increasing dividends, buying shares or purchasing other assets.

(9) Undermining the offeror: (a) court litigation to enjoin the offer, or administrative proceedings to block it, for violation of the securities, antitrust or other relevant laws; and (b) pressures on the offeror's financing sources to deny or revoke credit.

These and other techniques are later considered in further detail.¹²

¹² Secs. (2.520)-(2.540) *infra*.

F. *Meaning of Success* (1.600)

A successful tender offer in this article means an offer that obtains all the target securities wanted and at the price and time set by the offeror. The number of securities sought may be widely varying proportions of the total outstanding, depending on the offeror's objectives:

(1) Working control — hinges on the existing distribution of securities, but 20 to 30 percent suffices in many publicly held companies.

(2) Assured ability to elect a majority of the board of directors¹³ and ability to consolidate earnings and balance sheets¹⁴ — 50 percent plus.

(3) Assured ability to merge under the laws of most states — 66 2/3 percent.

(4) Ability to file consolidated returns for tax purposes,¹⁵ and to have a tax free exchange offer¹⁶ — 80 percent.

(5) Ability to use pooling of interest accounting under proposed AICPA rules¹⁷ — 90 percent.

(6) Assured ability to merge into the offeror without shareholder vote under the laws of some states¹⁸ — 90 or 95 percent.

Lesser results than those proposed by the offer do not necessarily make the offer unsuccessful in a larger sense. Enough target securities may have been obtained to give the offeror a substantial stake in the target company. Target company management may

¹³ Even a majority may not be enough if the directors are classified or staggered. If they are not, and there is no cumulative voting or other classes of voting securities, a majority of the shares elects the whole board.

¹⁴ SEC Reg. S-X, Rule 4-02(a), 17 C.F.R. § 210.4-02(a) (1969), *reprinted in* 4 CCH FED. SEC. L. REP. § 69,202, at 61,131. Minority interests must be separately accounted for. Rule 4-07, 17 C.F.R. § 210.4-07 (1969), *reprinted in* 4 CCH FED. SEC. L. REP. § 69,207, at 61,132.

¹⁵ INT. REV. CODE OF 1954, §§ 1501, 1504(a) [hereinafter cited as CODE]. There must be 80 percent ownership of any nonvoting stock too.

¹⁶ *Id.* § 368(a)(1)(B). See generally B. BITTKER & J. EUSTICE, FEDERAL INCOME TAXATION OF CORPORATIONS AND SHAREHOLDERS § 12.13 (2d ed. 1966).

¹⁷ AICPA, Proposed APB Opinion: Business Combinations and Intangible Assets § 46b (Exposure Draft Feb. 23, 1970), *discussed in* [Current Binder] CCH FED. SEC. L. REP. § 77-784, at 83,805. The consideration must be voting common stock, and many other conditions must be met. If there is a clear minimum for pooling in present accounting rules I am unable to find it. AICPA Accounting Research Bull. No. 48, § 4 (Jan. 1957), in 2 CCH ACCOUNTING PRINCIPLES 6081, requires a combination of "substantially all the ownership interests" of two companies for pooling. One accounting author says that this means 90-95 percent in practice. G. MCCARTHY, ACQUISITIONS AND MERGERS 119 (1963).

¹⁸ *E.g.*, ABA-ALI MODEL BUS. CORP. ACT § 68A (1967) (95 percent); DEL. CODE ANN. tit. 8, § 253, (1953), *as amended*, (Supp. 1968), (90 percent).

have been stimulated to greater efficiency or imagination. Market prices of target securities may have reached a higher plateau, with benefits for all holders.¹⁹

G. *Alternative Techniques* (1.700)

The tender offer is initially an acquisition of securities. These are usually voting securities which may also lead to working control of the target company through election of directors. Finally, the tender may produce a combination of the businesses of the offeror and the target company either in the formal legal sense (say, of merger) or in the economic sense. In each of these three aspects, there are alternatives to the tender offer.

1. *Securities Acquisition* (1.710).— As a method of obtaining ownership of target company securities, the tender offer is an alternative to purchase in the trading market, private purchase of outstanding securities, and direct purchase from the target company. The tender offer may be more or less effective in volume, speed and cost, depending on such factors as the kind of tender offer (cash, which is faster, or exchange), the nature of the trading market in target securities, the distribution of target company securities, and the disposition of the target company.

2. *Control Acquisition* (1.720).— As a method of acquiring control of the target company, the tender offer is an alternative to the other means of acquiring ownership, mentioned above, and to the proxy fight. The tender offer (at least for cash) is generally considered surer, cheaper and quicker than the proxy fight.²⁰

3. *Business Combination* (1.730).— As a method of business combination, the tender offer is an alternative to merger and purchase-sale of assets. It does not result in complete fusion of the offeror and the target company, for the latter continues to exist as a subsidiary, rarely wholly owned. For this reason, a tender

¹⁹ See BLAIR & CO., INC., *supra* note 5, at 12-13, advising prospective offerors to have a range of such goals in mind.

Some offerors have garnered large profits on resale of target securities. See Wall Street Journal, Jan. 27, 1969, at 1, col. 6; Comment, *supra* note 10, at 243, 246, noting also that even unsuccessful cash offers (in the 1967 period studied) produced a "permanently" higher price level for target securities than before the offer. For a list of figures, see *id.* at 248. But researchers of 1956-66 cash offers found that target securities lagged relative to comparable securities not involved in tender offers, more so if the offer failed. Hayes & Taussig, *supra* note 4, at 147, exhibit VII.

²⁰ Austin & Fishman, *supra* note 8, at 14-15 (tabulating 1956-67 results); Hayes & Taussig, *supra* note 4, at 137; Swanson, *S. 510 and the Regulation of Cash Tender Offers: Distinguishing St. George from the Dragon*, 5 HARV. J. LEGIS. 431, 436-37 (1968); Comment, *supra* note 10, at 239-40.

offer is often a prelude to a merger or asset transaction. At the initial stage it has the marked advantage to the offeror that it does not require corporate action by the target company, and can bypass a potentially hostile management in that company. Even if target management is cordial, the combination may take the form of a tender offer because the offeror prefers the lesser investment which results in a partially owned subsidiary. By preserving the target company's corporate entity, the tender offer may succeed where the other types of fusion fail, *e.g.*, if there are nontransferable rights in the target company, or restrictions on merger or asset sales in loan agreements or indentures.²¹ A cash offer is usually faster than a merger or asset deal; an exchange offer may take more or less time. A tender offer ordinarily does not require any shareholder approval in the offeror company,²² or create appraisal rights in shareholders of either company. In contrast, an asset sale usually creates voting and appraisal rights for shareholders of the selling company, and a merger does these things in both companies. But a tender offer does not eliminate minority interests; if that is desired, another step (*e.g.*, merger) is necessary.

Often a merger or asset transaction can be made at a lower premium per share than a tender offer, particularly if the offer is taxable while the alternative is not.

Another significant advantage of the tender offer is that it facilitates acquisition of a bank, insurance company or other regulated business which could not be merged with the offeror in another industry, and whose assets could not be bought directly. Triangular mergers will do the job, but few states yet authorize them.²³

The antitrust laws, by my minimal understanding of them, treat tender offers like mergers and other forms of business combination.

Within the class of tender offers, there are important differences

²¹ Similar restrictions on tender offers are now written into some agreements. See Note, *Defensive Tactics Employed by Incumbent Managements in Contesting Tender Offers*, *supra* note 11, at 1109.

²² For exceptions, see text accompanying note 77-78 *infra*.

²³ See DEL. CODE ANN. § 251(b)(4) (1953), *as amended*, (Supp. 1968), permitting X corporation to merge into Y corporation upon issuance of securities of Z corporation (the parent of Y). Under most statutes, the only securities issuable in a merger are those of Y, the surviving corporation. See, *e.g.*, ABA-ALI MODEL BUS. CORP. ACT § 65(c) (1967). Acquisition through a subsidiary can be accomplished in most states with parent securities by transferring the parent securities to the subsidiary, and the subsidiary using them as consideration for an asset purchase from the other company. But this is not technically a merger except under statutes like Delaware's.

between cash and exchange offers. The former are always taxable, the latter sometimes are not.²⁴ An exchange offer requires no current funds, paying rather by commitment of future funds through issuance of debt securities, or by issuance of equity securities with a corresponding possibility of dilution. Target securityholders get a less certain value in an exchange offer than in a cash offer, but it is not always possible to predict which they will find more appealing.

II. COMPETING INTERESTS: SAFEGUARDS AND RESTRAINTS

A. *Introduction* (2.000)

1. *Kinds of Interests* (2.010).— A number of disparate interests in a tender offer can be identified. We consider them separately at the points indicated, under the following categories:

- a. Offeror (2.100)
- b. Offeror Management (2.200)
- c. Offeror Securityholders (2.300)
- d. Offeror Constituents (2.400)
- e. Target Company (2.500)
- f. Target Company Management (2.600)
- g. Target Securityholders (2.700)
- h. Other Target Company Securityholders (2.800)
- i. Target Company Constituents (2.900)
- j. Third Persons and the Market (2.1000)

The interests are primarily economic, but they include many other possibilities, ranging from psychological to patriotic.

2. *Kinds of Safeguards* (2.020).— The several interests are protected in a number of ways:

- (1) Self-help by the parties, including economic actions and transactions.
- (2) Statutory requirements and fiduciary principles of state corporate law.
- (3) General antifraud provisions of federal and state securities law.
- (4) Registration, disclosure and special antifraud provisions of federal and state securities law in an exchange offer.
- (5) Tender offer disclosure and antifraud provisions of the

²⁴ See CODE § 368(a)(1)(B). See generally B. BITTKER & J. EUSTICE, *supra* note 16.

1968 amendments to federal securities law, *i.e.*, the Williams Bill,²⁵ in a cash offer.

(6) Proxy disclosure and antifraud provisions of federal law (and possibly state law) if proxies are solicited from target security-holders with their tenders, or for a defensive merger, or from securityholders of the offeror for their authorization of the offer.

(7) Qualitative requirements of the terms of some offers covered by the Williams Bill.

Rather than write about these seven categories, I will review the interests of the various parties, and consider how each of them can use the relevant categories, or are limited by them.

3. *Kinds of Restraints* (2.030).— To a large extent the restraints on one interest group come from the safeguards for another group. To the extent they are legal safeguards, they may be enforced by legal restraints, such as court decrees or administrative orders. Short of this, they are usually observed out of respect for the law or in deference to the legal restraints available. In addition, there are economic, market and tax restraints of varying force.

These restraints and a few others are examined in the following discussion, under the groups to which they apply.

4. *Problems in Evaluation* (2.040).— To list the interests, restraints and safeguards is to reveal an intricate set of checks and balances. But this is not enough to quantify or evaluate them. Even in the abstract, this can be done only crudely, if at all. In a concrete case, it may be even harder, for example, to weigh the interests of employees of one company against those of security-holders in another company. All too often this is comparing apples and oranges, and tastes differ. To complicate the task further, there is a shifting membership of some of the classes. For example, the high volume of trading in target securities during the Offer Period means a considerable change in the persons who own these securities. Are the interests of a 5-year holder of target securities the same as those of one who bought 5 minutes after the start of the offer? Are they entitled to equal safeguards? There is no ready answer.

Nonetheless, I will hazard a judgment on the adequacy and propriety of the safeguards and restraints for each group.

B. *Offeror* (2.100)

1. *Interests* (2.110).— The offeror has the greatest direct, eco-

²⁵ 15 U.S.C. §§ 78m(d)-(e), n(d)-(f) (Supp. IV, 1969).

conomic interest in the offer. In addition to the consideration it may have to pay (in cash or securities), it has incurred substantial costs in preparing for the offer, such as commitment fees of financing a cash offer, costs of SEC registration of an exchange offer (mainly legal, accounting and printing expenses), charges of dealer-managers and solicitors, not to mention the costs of investigation and evaluation of the target company. It has a less direct economic stake in the opportunity for growth, diversification and profit that motivated the offer in the first place. The trading market's reaction to the offer will affect the value of its securities in the short run and perhaps in the long run.

The offeror's main concerns, then, are to effectuate the offer and its related plans for the target company, and to protect itself from loss if the offer fails.

The offeror may have other capacities which give it, if not other interests, at least other leverage to press its interests as offeror. For example, it will commonly be a stockholder of the target company by the time the offer starts. Thus it will have standing to enforce fiduciary obligations of target company management.²⁶

2. *Safeguards and Restraints in Making the Offer* (2.120).

a. *Contract* (2.121).— The offeror enjoys freedom of contract in setting the terms of the offer, within some fairly severe limits noted below. The offer can vary in many important ways:

- (1) It may be for one or more classes of target securities.²⁷
- (2) It may be for any specified proportion of a class of target company securities.²⁸
- (3) It may be contingent on a minimum number of acceptances or tenders.
- (4) It may reserve the right to take more or less.
- (5) The consideration offered may be cash or securities, and

²⁶ See, e.g., *Northwest Indus., Inc. v. B.F. Goodrich Co.*, 301 F. Supp. 706 (E.D. Ill. 1969), finding, however, no probability that the plaintiff could prove breach of duty. The offeror was apparently suing derivatively as a target company shareholder in *Condec Corp. v. Lunkenheimer Co.*, 43 Del. Ch. 353, 230 A.2d 769 (Ch. 1967) (target company issuance of additional shares cancelled).

²⁷ Normally the offer will be for the class with greatest voting control, e.g., common stock, but may also be for securities convertible into common stock, or for warrants to purchase common stock. If the significant voting power is in some other security, this will commonly be sought. For an example, see *Allied Artists Pictures Corp. v. D. Kaltman & Co.*, 283 F. Supp. 763, 764 n.1 (S.D.N.Y. 1967) (tender offer for preferred shares which, because of dividend arrearages, had power to elect majority of directors). Debt securities, otherwise without voting power, may have rights to vote on a bankruptcy reorganization plan, which would make them possible objects of a tender offer.

²⁸ For some of the relevant factors, see sec. (1.600) *supra*.

the latter may include various classes of shares, debt or warrants. If the consideration is cash, there must be an adequate source of funds,²⁹ which must be disclosed.³⁰ If the consideration is securities, they must ordinarily be registered under the Securities Act of 1933³¹ and under any applicable state securities law.

Lesser, but still significant, variables include:

- (6) The duration of the offer, and any right to extend it.
- (7) The mechanics of tendering.³²
- (8) Withdrawal rights prior to the offeror's final takeup of acceptances (*i.e.*, revocability of tenders).
- (9) Whether acceptances will be taken up first-come-first-served, or pro rata or otherwise, and whether the arrangements will be the same throughout the offer.
- (10) Conditions on the taking up of tenders, such as no material adverse change (as determined by the offeror) in the financial condition of the offeror or of the target company.
- (11) Price adjustments for any extraordinary distributions by the target company.
- (12) When payment is to be made.
- (13) Whether proxies on tendered shares are solicited, and, if so, on what terms.
- (14) Commissions to be paid brokers for obtaining acceptances.

b. *Market* (2.122).— The offeror enjoys freedom of the market in fixing the terms of the offer, particularly how many se-

²⁹ SEC v. Fenster, SEC Litigation Release Nos. 3728 (May 25, 1967), 3741 (June 2, 1967) (S.D. Cal. 1967), *discussed in* Wall Street Journal, May 25, 1967, at 3, col. 2, and in *id.* May 26, 1967, at 5, col. 2; SEC v. Zweifach, SEC Litigation Release Nos. 3858 (Nov. 16, 1967), 3875 (Dec. 1, 1967) (S.D.N.Y. 1967). The SEC obtained injunctions against insufficiently funded offerors, invoking the antifraud provisions.

On the effect of the margin rules, Securities Exchange Act of 1934, § 7, 15 U.S.C. § 78g (Supp. IV, 1969) [hereinafter cited as Exchange Act], see Comment, *Application of Margin Requirements to the Cash Tender Offer*, 116 U. PA. L. REV. 103 (1967).

³⁰ See sec. (2.721) *infra*.

³¹ Securities Act of 1933, § 5, 15 U.S.C. § 77e (1964) [hereinafter cited as Securities Act]. By hypothesis, the target company is publicly held, so that the private offering exemption is inapplicable. *Id.* § 4(2), 15 U.S.C. § 77d(2) (1964). If all the target securityholders were in a single state where the offeror was incorporated and doing business, the intrastate exemption might be available. *Id.* § 3(a)(11), 15 U.S.C. § 77c(a)(11) (1964). If the offeror is a bank or common carrier, its securities may be exempt. *Id.* §§ 3(a)(2), (6), 15 U.S.C. §§ 77c(a)(2), (6) (1964). Other, less important, exemptions in sections 2 and 3 might be applicable. *Id.* §§ 2, 3, 15 U.S.C. §§ 77b, c (1964).

³² See *Walston & Co., Inc. v. Haven Indus., Inc.*, [1967-69 Transfer Binder] CCH FED. SEC. L. REP. ¶ 92,364, at 97,721 (S.D.N.Y. Mar. 3, 1969) (telegraphic tender not received before expiration as required by exchange offer).

curities it wants³³ and at what price, and how much it will pay brokers to procure them. At the same time, it subjects itself to the constraints of the market. The offer price should be high enough to attract the desired tenders. It should be low enough to avoid a dilution of earnings per share for the offeror and a drop in the market price of its securities. The magic range can never be foretold with complete accuracy. In an exchange offer, the constraints are even more complex, both because the offer price itself will fluctuate in the trading market, and because the investor appeal of one or more securities is less predictable than the appeal of cash. The offeror commonly has the advice of dealer-managers and analysts in fixing the terms of the offer.³⁴

c. *Securities and Corporate Law* (2.123).— The offeror is subject to some legal restraints in making an offer. If it is an outsider, there are antifraud and disclosure requirements under federal securities laws.³⁵ If it is an insider, such as a controlling shareholder of the target company, there is an additional obligation of fairness, especially as to price.³⁶ Even an outsider may be an insider in the sense developed in Rule 10b-5 jurisprudence if the offeror has received material information about the target company in the course of negotiations with it. In such a case, the offeror would violate Rule 10b-5 by buying securities pursuant to the offer (or in the trading market) before the information had been disclosed and absorbed.³⁷

The offeror also has freedom to improve the offer by increasing the consideration, subject to the further constraint that the

³³ For some of the variables in choosing the desired number of target securities, see sec. (1.600) *supra*.

³⁴ Kelly, *Some Observations on Contested Take-Over Bids*, 15 N.Y.L.F. 619, 628-29 (1969), says that the dealer-manager in an exchange offer, who serves as a sort of underwriter, does not ordinarily perform the investor-protecting function of an underwriter in a cash offer. He arrives later on the scene and is not in a position to insist upon protective provisions in debentures, shares, or warrants being offered. He almost never has a firm commitment to dispose of the offered securities. On the other hand, he is equally an underwriter for purposes of Securities Act liabilities, *e.g.*, under section 11. Securities Act § 11 15 U.S.C. § 77K (1964); *see id.* § 2(11), 15 U.S.C. § 77b(11) (1964) (definition of underwriter). The dealer-manager or other financial adviser to the offeror normally does not purport to be an independent expert, as he may be in recommending the terms of a merger, or in a transaction involving a conflict of interest.

³⁵ *See* secs. (2.525), (2.721) *infra*.

³⁶ *Speed v. Transamerica Corp.*, 99 F. Supp. 808, 843 (D. Del. 1951); *Epstein v. Celotex Corp.*, 43 Del. Ch. 504, 238 A.2d 843 (Ch. 1968).

³⁷ *See* A. BROMBERG, *supra* note 2, at § 7.4.

higher consideration must be paid to all persons who have previously tendered pursuant to the same offer.³⁸

The duration of the offer, the right to withdraw tenders, and the taking up of acceptances are limited by federal law.³⁹

The offeror apparently has freedom of the market to accumulate target company shares before the offer is made known.⁴⁰ Transactions within 60 days of the offer must be disclosed in the offer.⁴¹

The offeror's freedom to use the trading market to buy target securities outside the tender offer was curtailed in 1969 when the SEC promulgated Rule 10b-13⁴² to prohibit this practice after the first public announcement of the offer.

The offeror enjoys freedom of timing the offer in varying measures. In a cash offer, it has virtually complete control over when it will make the offer. In an exchange offer which has to be registered, it must wait for SEC and state clearance. In either case, there will normally be restraints on how briefly it can keep the offer open.⁴³

d. *Tax Law* (2.124).— The federal income tax law imposes some restraints on the offeror directly, and indirectly through its impact on target securityholders. The primary effects are on the kinds and amount of consideration offered. In order to have a tax-free transaction for target securityholders, only voting stock may be offered.⁴⁴ This can be (and often is) a voting preferred with higher dividend and lower vote (relative to value) than the offeror's common. A nontaxable exchange requires that the offeror have 80 percent of the common stock of the target company after the offer (some of which it may have acquired previously). The offeror has these alternatives:

- (a) Seeking 80 percent and using voting stock, usually with

³⁸ See sec. (2.724) *infra*.

³⁹ See sec. (2.723) *infra*.

⁴⁰ See *General Time Corp. v. Talley Indus., Inc.*, 403 F.2d 159, 164 (2d Cir. 1968), *cert. denied*, 393 U.S. 1026 (1969) (no violation in open market purchases and a special bid in anticipation of a merger offer by the buyer); A. BROMBERG, *supra* note 2, § 6.3(835) n.41.1; Bromberg, *Tender Offers*, *supra* note 2, at 542 n.442. If the buyer is an insider of the target company, the situation may be quite different.

If the offeror uses investment companies as allies to help accumulate target company shares, a whole new series of problems arise. See Thomas, *Warehousing*, 3 REV. SEC. REG. 975 (1970).

⁴¹ See secs. (2.721)(6), (8) *infra*.

⁴² SEC Exchange Act Rule 10b-13, 17 C.F.R. § 240.10b-13 (1969), *reprinted in* 2 CCH FED. SEC. L. REP. ¶ 26,752, at 20,071-4.

⁴³ See sec. (2.723) *infra*.

⁴⁴ CODE § 368(a)(1)(B). See generally B. BITTKER & J. EUSTICE, *supra* note 16.

no certainty that it will get 80 percent (especially in a contested offer), with corresponding uncertainty for target securityholders about their tax results and a probable damper on their tendering. This alternative may require a higher price per share than would attract a smaller percentage of target securities, and it abandons the leverage of working control that may be possible by acquiring a small majority or a minority of the target securities.

(b) Seeking less than 80 percent, or using cash, debt, warrants or nonvoting stock, with a taxable exchange, lower appeal to target securityholders, and the need to set a price high enough that the after-tax residue will still be attractive for target securityholders.⁴⁵

The possibility of a tax-deferred exchange of readily marketable debt securities, using the installment sale provisions, was ended by the Tax Reform Act of 1969.⁴⁶

A different part of the 1969 tax law imposes other constraints on an exchange offer which includes debt securities. In general terms, interest payments above \$5 million a year are not deductible for subordinated, convertible (or warrant-accompanied) debt issued to acquire the stock of the target company if the offeror ends up with a debt-equity ratio higher than 2:1 (or if its projected earnings cover all interest requirements less than three times).⁴⁷ This law affects the type of debt security offered, the size of the offering and thereby the proportion of target securities sought.⁴⁸ The overall effect is to discourage exchange offers of debt securities.

The 1969 tax provisions were designed to raise revenue and to discourage conglomerate takeovers by tender offers or other means. They are sure to have a deterrent effect on tender offers.

⁴⁵ The tax rates for holders of target securities will vary considerably, depending on (1) whether they hold target securities as capital assets or (like many broker-dealers) as stock in trade or for sale to customers [CODE § 1221]; (2) whether they have held more than 6 months in order to qualify for long-term capital gain treatment if the securities are capital assets [*id.* §§ 1222(3), (7)]; (3) the level of their other ordinary income which may make the deduction for capital gain [*id.* § 1202] more favorable in their rate brackets than the alternative tax [*id.* § 1201]; and (4) the level of their other capital gains, and whether or not they are corporations, for determining the rate of the alternative tax [*id.* §§ 1201(a)-(c)], and of the minimum tax on preferences [*id.* §§ 56, 57(a)(9)]. Many of these variables were introduced by the Tax Reform Act of 1969 [83 Stat. 487], which made the pricing of a tender offer considerably more intricate.

There is a tendency to set a price which will be more attractive to the larger holders, who are likely to be in higher tax brackets. Holders in lower brackets, usually the smaller ones, get a bit of a windfall.

⁴⁶ CODE § 453(b)(3).

⁴⁷ *Id.* § 279.

⁴⁸ With current interest rates on convertible debt around 7 percent, the \$5 million limit means that companies will rarely want to bring their total outstanding acquisition debt (including debt issued in exchange offers) above some \$70 million.

e. *Other* (2.125).— If the target company management opposes the offer, or is expected to do so, there is another serious restraint on the offeror: lack of access to internal records and information of the target company. Without them, the offeror has a much weaker basis for pricing the offer (or even for deciding whether to offer at all) and for making plans for the target company if the offer succeeds.⁴⁹ A byproduct is the absence of the detailed warranties and representations which invariably are made in negotiated mergers and asset acquisitions.

3. *Safeguards and Restraints in Communications* (2.130).— The success of the offer depends heavily on the offeror's ability to communicate with the offerees. There are several restraints on this freedom. In a cash offer, certain information has to be filed with the SEC and included in the offer.⁵⁰ On the whole, this is a mild restraint unless the disclosures are embarrassing. But one of the disclosures — the required statement of purposes and plans for the target company — will often be troublesome and litigation breeding because of the probable contingencies in plans at the beginning of the Offer Period.⁵¹ This is especially true in a contested offer, where the matter is most likely to go to court. In an exchange offer, which typically has to be registered with the SEC under the 1933 Act,⁵² there is a prohibition on conditioning publicity before the registration statement is filed, a ban on favorable projections and predictions throughout the offer, a requirement that all written offers (other than tombstone ads) be by prospectus, and a general muffling of salesmanship.⁵³ This can create

⁴⁹ See Kelly, *supra* note 34, at 623-26.

⁵⁰ See note 172 *infra*.

⁵¹ See *Pan American Sulphur Co. v. Susequehanna Corp.*, [Current Binder] CCH FED. SEC. L. REP. ¶ 92,473, at 98,233 (W.D. Tex. May 28, 1969), *rev'd*, [Current Binder] CCH FED. SEC. L. REP. ¶ 92,610, at 98,749 (5th Cir. Mar. 13, 1970); *In re Susquehanna Corp.*, [Current Binder] CCH FED. SEC. L. REP. ¶ 77,741, at 83,692 (SEC Hearing Examiner Aug. 5, 1969), both involving the adequacy of disclosure of intentions to use the target company as a vehicle for further acquisitions. For further discussion, see A. BROMBERG, *supra* note 2, §§ 6.3(450)-(468); Bromberg, *Tender Offers*, *supra* note 2, at 493-503.

⁵² Securities Act § 5, 15 U.S.C. § 77e (1964).

⁵³ *Chris-Craft Indus., Inc. v. Bangor Punta Corp.*, [Current Binder] CCH FED. SEC. L. REP. ¶ 92,510, at 98,372 (2d Cir. Nov. 6, 1969) (violation of section 5 [Securities Act § 5, 15 U.S.C. § 77e (1964)] in announcing that an exchange offer would be made with a value of \$80 per target company share, in opinion of named investment banker). *Accord*, *SEC v. Bangor Punta Corp.*, [1967-69 Transfer Binder] CCH FED. SEC. L. REP. ¶ 92,428, at 98,021 (D.D.C. May 26, 1969). See generally Carl M. Loeb, Rhoades & Co., 38 S.E.C. 843 (1959); SEC Securities Act Release No. 3844, in 1 CCH FED. SEC. L. REP. ¶¶ 3250-56, at 3108-13; 1 L. LOSS, SECURITIES REGULATION 215-21 (2d ed. 1961); 4 *id.* 2318-20 (Supp. 1969); SEC, REPORT ON DISCLOSURE TO INVESTORS — A REAPPRAISAL OF FEDERAL ADMINISTRATIVE

a serious imbalance in a contested offer, for the opponents are not similarly restricted in their statements.

The offeror normally has several means to disseminate the offer widely and follow up on it: direct mail to holders, newspaper (and perhaps magazine) advertising, releases to the financial press, and brokers.

Direct mail will usually reach a larger proportion of target securityholders than any other method. But it does not directly touch beneficial owners of securities in street name, or even indirectly holders of bearer securities. Moreover, it is expensive, especially with a fat prospectus for an exchange offer. And it may be impossible if uncooperative target management denies access to the securityholders list. The offeror can, as a shareholder of the target company, eventually get the list by suing under state law,⁵⁴ but it is perhaps too late to do much good.

Newspaper and similar advertisements can inform many target securityholders if the publications are well chosen and not too costly. But effective placement of the ads requires some knowledge of the distribution of target securities. There may be local concentrations of ownership not reached by the *Wall Street Journal* or the *New York Times*. Nor is it clear how effective the ads are in telling securityholders or in eliciting response. They probably do a better job in a cash offer. A dollar price is instantly meaningful. And the ad can include the entire offer and transmittal letter, so that the persuaded holder can act at once. An exchange offer ad might consist of the entire SEC prospectus plus a transmittal letter, but this would be unthinkable costly. Rather, the published version is in practice limited to the tombstone ad which says little more than that X Co. is offering securities in a stated ratio to the holders of Y securities for a certain period, but that the offering is made only by prospectus, obtainable from named sources. The investor may be put off. Even if he wants to act, it will take him minutes or days, depending on where he is, to get the transmittal letter and prospectus.

Press releases will go out on the wire services to many brokers, analysts and institutional investors, some of whom may be (or have influence with) large holders of target securities. Releases will also produce some informative news stories about the offer in the daily

POLICIES UNDER THE '33 AND '34 ACTS 16-18, 127-48 (CCH ed. 1969) [referred to as WHEAT REPORT].

⁵⁴Mite Corp. v. Heli-Coil Corp., 256 A.2d 855 (Del. Ch. 1969). See E.L. Bruce Co. v. Delaware, 51 Del. 252, 144 A.2d 533 (1958).

or weekly press, most likely in those publications carrying ads for the offer.

Very often the brokers are crucial communication links. They may hold target securities in street name for their customers, in which case they are obliged to forward the offer if the offeror pays the expense.⁵⁵ These are holders the offeror could not contact directly with a securityholders list, since they do not appear on it. Even with the broker's obligation to forward the offer, much depends on his promptness in doing so. In addition, brokers will often call other customers whom they know to be holders of target securities. Moreover, the brokers tend to recommend acceptance of the offer, because of the attractive commissions they hope to collect from the offeror. The brokers may be influential with large institutional holders of target securities, who are often critical to the success of an offer. Finally, the brokers may themselves become arbitrageurs in support of the offer, or induce customers to assume this role.

To the extent possible, these channels will be used to recirculate the offer and solicit acceptances. In addition, personal solicitation will be employed for big holders of target securities who can be identified.

4. *Safeguards Against Defeat of the Offer (2.140).*— The offeror's main assurance against defeat is in making the market value of the offer attractive, as discussed above.⁵⁶

The offeror is not protected against opposition, or against competitive buying of target securities.⁵⁷ It is protected against fraudulent or deceptive opposition by section 14(e) of the Securities Exchange Act of 1934 and to some degree by Rule 10b-5, and should have corresponding standing to sue for violations.⁵⁸ There

⁵⁵ N.Y. Stock Exch. Rule 465, in 2 CCH N.Y.S.E. GUIDE, § 2465 (1964). American Stock Exch. Rule 585, in 2 CCH A.S.E. GUIDE § 9537 (1968); Midwest Stock Exchange, Art. XXX, Rule 7, in CCH M.S.E. GUIDE § 2597 (1968). Quite apart from the rules applicable to members of these exchanges, there is probably a broader fiduciary obligation of a broker to notify his customer of such an offer if not actually to forward it.

⁵⁶ Sec. (2.122) *supra*.

⁵⁷ See *National Union Elec. Corp. v. National Presto Indus., Inc.*, [Current Binder] CCH FED. SEC. L. REP. § 92,460, at 98,178 (W.D. Wis. July 8, 1969) (refusing a temporary restraining order against target company purchases of its own securities).

The target company must file and disseminate certain information before it can buy its own shares. See SEC Exchange Act Rule 13e-1, 17 C.F.R. § 240.13e-1 (1969), reprinted in 2 CCH FED. SEC. L. REP. § 26,852, at 20,107-3.

⁵⁸ Exchange Act § 14(e), 15 U.S.C. § 78n(e) (Supp. IV, 1969), expressly applies antifraud provisions to "any solicitation in opposition to or in favor of any" tender offer.

remains the difficulty of fashioning suitable relief after a violation has occurred in a typically brief, bitter contest. The Court of Appeals for the Second Circuit has recently indicated that the only limit is equity to all parties concerned.⁵⁹

Just what amounts to fraud or deception in a tender offer is not fully developed. But it includes any misrepresentation of information likely to be material to a target securityholder in making his decision whether to tender,⁶⁰ any nondisclosure of similar import,⁶¹ and deceptive market transactions.⁶²

The SEC has powers, largely unused, to seek an injunction against a violation such as manipulation,⁶³ or to suspend trading

The duties seem to be symmetrical for proponents and opponents, and symmetrical standing to sue should follow.

The case is less clear under SEC Exchange Act Rule 10b-5, 17 C.F.R. § 240.10b-5 (1969). Many courts confine standing to buyers or sellers of securities. A trend of relaxation has been evident. See A. BROMBERG, *supra* note 2, § 8.8. But the Second Circuit has recently restated the Rule 10b-5 standing limitation to bar a cash tender offeror from suing. *Iroquois Indus., Inc. v. Syracuse China Corp.* 417 F.2d 963, 969-70 (2d Cir. 1969) (indicating, however, that there would be standing under section 14(e)). A month later another panel of the same court accorded Rule 10b-5 standing to an exchange offeror who was a "forced seller" of target securities through this chain of events: (1) failure of the offer, caused by violations by the target company and its proposed merger partner; (2) target company merger with a competitor of the offeror; (3) threat of antitrust litigation against the offeror if it retained its holdings in the merged company; and (4) sale of offeror's holdings in the merged company. *Crane Co. v. Westinghouse Air Brake Co.*, 419 F.2d 787 (2d Cir. 1969). Dictum also indicated that the offeror had standing under section 14(e). *Id.* at 798-99. The distinction between a cash offer and an exchange offer has no functional significance here. Apart from divergent views of the judges, the difference in result seems to lie in the "forced seller" fortuity. And in *Chris-Craft Indus., Inc. v. Bangor Punta Corp.*, [Current Binder] CCH FED. SEC. L. REP. ¶ 92,510, at 98,372 (2d Cir. Nov. 6, 1969), an offeror was allowed to sue, primarily for violation of the Securities Act, without any discussion of its standing.

⁵⁹ *Crane Co. v. Westinghouse Air Brake Co.*, 419 F.2d 787, 803-04 (2d Cir. 1969) (remedy may include damages, injunction, divestiture, or separation of target company's merger into an ally). For further discussion of remedies, see cases cited notes 121, 141 *infra*; A. BROMBERG, *supra* note 2, §§ 6.3(1100)-(1130); Bromberg, *Tender Offers*, *supra* note 2, at 555-66.

⁶⁰ *Butler Aviation Int'l, Inc. v. Comprehensive Designers, Inc.*, [Current Binder] CCH FED. SEC. L. REP. ¶ 92,557, at 98,541 (2d Cir. Jan. 8, 1970) (misrepresentation of exchange offeror's past and predicted earnings).

⁶¹ *Crane Co. v. Westinghouse Air Brake Co.*, 419 F.2d 787, 795-96 (2d Cir. 1969) (nondisclosure of market manipulation by target company ally was a separate violation). See also *Symington Wayne Corp. v. Dresser Indus., Inc.*, 383 F.2d 840 (2d Cir. 1969) (finding, however, that the nondisclosures by the offeror were not material).

⁶² *Crane Co. v. Westinghouse Air Brake Co.*, 419 F.2d 787 (2d Cir. 1969). "The manipulation may be found to have deprived [the offeror] of success in its tender offer in the free market to which it was entitled." *Id.* at 803-04.

⁶³ For examples of SEC injunctions in tender offers, see authorities cited note 29 *supra*.

in any security involved if it concludes that public interest and investor protection so require.⁶⁴

If the target company solicits proxies, as for a defensive merger, the disclosure and antifraud provisions of the proxy rules offer some protection to the offeror, who probably has standing to sue.⁶⁵ At the same time, the offeror's pursuit of the offer may be regarded as solicitation of proxies against the merger, requiring it to comply with proxy rules.⁶⁶

5. *Critique* (2.150).— The offeror is, on the whole, suitably safeguarded by its initiative and freedom of action in the market. There is only one serious gap in the protections afforded the offeror. This is the lack of assurance of communication with target securityholders. State corporate law inspection rights may fill the gap, but there is much to be said for a federal securities law provision to this effect. An analogy exists in the proxy rules, which require a company to elect either to furnish a list or to mail the opposition's solicitation.⁶⁷ A still stronger argument for this sort of requirement can be made in behalf of target securityholders.⁶⁸

A second problem is a heavy restraint on what an exchange offeror can say, while the opposition, if any, is constrained only by the fraud provisions. The offeror cannot talk about value or make projections, but the other side can. There are two ways to re-

⁶⁴ Exchange Act § 15(c)(5), 15 U.S.C. § 78o(c)(5) (Supp. IV, 1969); *id.* § 19(a)(4), 15 U.S.C. § 78s(a)(4) (1964). See generally Goldman & Magrino, *Suspension of Trading in Securities: Some Observations on Section 15(c)(5) of the Securities Exchange Act of 1934*, 15 N.Y.L.F. 633 (1969); Comment, *Summary and Successive Suspension of Trading under the Exchange Act of 1934: The Constitution, the Congress and the SEC*, 18 CATH. U.L. REV. 57 (1968); 1 SECURITIES L. REV. 578 (1969).

I am aware of only one SEC suspension in the context of a tender offer. The Commission suspended trading in J. J. Newberry Co. when an offer for its shares was published by someone apparently unable to pay. The suspension was lifted a day later after the SEC had filed an injunction complaint against the offeror, alleging antifraud violations, and had publicized the contents of the complaint. SEC News Digest, May 25, 1967, at 1; *id.* May 26, 1967, at 1. For the litigation side of the action, see SEC v. Fenster, SEC Litigation Release Nos. 3728 (May 25, 1967), 3741 (June 2, 1967) (S.D. Cal. 1967). For other SEC powers, see authorities cited note 179 *infra*.

⁶⁵ See *Crane Co. v. Westinghouse Air Brake Co.*, 419 F.2d 787 (2d Cir. 1969) (finding, however, no proxy violation). On the applicability of the proxy rules, see note 80 *infra* & accompanying text.

⁶⁶ See *Brown v. Chicago, R.I. & Pac. R.R.*, 328 F.2d 122 (7th Cir. 1964) (holding, however, that the advertisements in question were not solicitations); *cf.* *Union Pac. R.R. v. Chicago & N.W. Ry.*, 226 F. Supp. 400 (N.D. Ill. 1964) (broker's report evaluating merger and exchange offer was solicitation; resolicitation required).

⁶⁷ SEC Exchange Act Rule 14a-7, 17 C.F.R. § 240.14a-7 (1969), *reprinted in* 2 CCH FED. SEC. L. REP. ¶ 26,861, at 20,116. The proxy provision does not guarantee disclosure of the size of holdings, and thus permits no concentrated salesmanship. 2 L. LOSS, *supra* note 53, at 892. Is something more needed in a tender offer?

⁶⁸ See sec. (2.790) *infra*.

store balance: liberalize the rules for the offeror, or tighten them for the target company. The SEC favored the latter method at the time of the Williams Bill.⁶⁹ Senator Williams introduced a bill in 1970 that would have this effect.⁷⁰ My judgment is that a better balance for all concerned would be to let the offeror say more, subject always to the antifraud rules.⁷¹ The other restraints of registration — cost, delay, SEC review — are fully justified, but the limitations on the offeror's solicitations are less so.

C. Offeror Management (2.200)

1. *Interests* (2.210).— The management of the offeror has interests which are likely to be very closely aligned with those of the offeror itself. There may additionally be ego factors that make the leaders more eager to control the target company, or to enjoy notoriety from the offer, than the economics justify. Defeat of the offer may cause psychic wounds to their reputations as managers, so they may be more aggressive than the situation warrants. They are likely to see themselves, especially in a contested offer, as bold and efficient deployers of resources, and the target company and its management as timid and inefficient.

2. *Safeguards* (2.220).— The offeror's management is not separately accorded any protections but shelters under the same ones granted the offeror.

3. *Restraints* (2.230).— The restraints on the management of the offeror are largely the same as those on the offeror, plus their duties of care and loyalty to the corporation.⁷²

4. *Critique* (2.240).— Management of the offeror is adequately protected by the safeguards for the offeror. The restraints seem suitable within the very broad discretion allowed management in the contemporary business and legal environment. Perhaps a little more restraint — in the form of securityholder approval — is needed on tender offers which involve a disproportionate alloca-

⁶⁹ *Hearings on S. 510, Before the Subcomm. on Securities of the Sen. Comm. on Banking and Currency, 90th Cong., 1st Sess. 28-29, 38, 41, 201 (1967).*

⁷⁰ S. 3431, 91st Cong., 2d Sess. § 3 (1970). The proposal would eliminate the exemption of registered exchange offerings from the 1968 Williams Bill and thus bring them under the SEC's power to regulate opposition solicitations pursuant to section 14(d)(4) of the Exchange Act. Exchange Act § 14(d)(4), 15 U.S.C. § 78n(d)(4) (Supp. IV, 1969).

⁷¹ See Bromberg, *Exchange Offers*, *supra* note 3, at 813.

⁷² See authorities cited notes 75-76 *infra*. See generally Schwartz, *Personal Liabilities of Directors of an Acquiring Company*, 4 M&B & ACQUISITIONS 4 (No. 2, Mar.-Apr. 1969).

tion of assets or capitalization, or a marked deviation from the kind of business previously conducted.⁷³

D. Offeror Securityholders (2.300)

1. *Interests* (2.310).— The securityholders of the offeror have an interest in seeing that their values are enhanced, or at least not diminished, by the offer.⁷⁴ They are concerned not only in their individual appraisals of the offer, but in the trading market reaction to it. Since this will be gauged largely by the current and projected effect on earnings per share, they are especially interested in the dilution effect of the offer (if it is an exchange offer) or the diversion of assets (if it is a cash offer). So far as price goes, the interests of securityholders of the offeror are directly contrary to those of holders of target securities. The former want a low price, the latter a high one.

2. *Safeguards* (2.320).— The safeguards for securityholders of the offeror include resort to the market to sell their securities or to buy target securities if they regard the offer price as injuriously high to the offeror. In this instance they may have also a state law cause of action for waste or negligence;⁷⁵ if timely brought, an injunction against the offer may issue. Or later monetary relief against the directors and executives may be granted. However, given the judicial deference to business judgment, the securityholders' chances of success are relatively slight. They improve if

⁷³ For further discussion, see sec. (2.340) *infra*.

⁷⁴ Some offers have produced serious reverses for offerors. General Host reportedly lost \$50 million on its 1969 exchange offer for Armour when it resold its holdings to Greyhound. N.Y. Times, Feb. 26, 1970, at 55, col. 1 (city ed.). Liquidonics lost \$17 million on its cash offer for UMC Industries, when it later disposed of the securities under pressure to pay its debts. *When a Mouse Tries to Swallow an Elephant . . .*, FORBES, Mar. 1, 1970, at 44; N.Y. Times, Dec. 27, 1969, at 33, col. 6. International Controls had a \$15 million paper loss on its offer for Electronic Specialty by the time the litigation reached the appellate court, 5 months after the offer. *Electronic Specialty Co. v. International Controls Corp.*, 409 F.2d 937, 947 (2d Cir. 1969). By early 1970, LTV had a \$212 million paper loss on Jones & Laughlin shares bought for \$550 million cash in mid-1968. FORBES, Mar. 15, 1970, at 57.

Losses of this kind are inevitably reflected in the value of the offeror's securities. General Host common was selling at \$40 per share a couple of months before it made its offer for Armour in January 1969. A year later it was around \$12 per share. Liquidonics took a more spectacular nosedive, from \$114 to \$13 per share. International Controls went from \$46 to \$13 per share in early 1970. LTV common dropped from \$48 to \$24 per share. The offers were not the only factors. 1969 was a year of general declines. For a tabulation of 22 tender offers and the later market values of the securities involved, see *The Morning After*, FORBES, Feb. 1, 1970, at 15-16.

⁷⁵ See *Norte & Co. v. Huffines*, 304 F. Supp. 1096, *aff'd*, 416 F.2d 1189 (2d Cir. 1969), *cert. denied*, 38 U.S.L.W. 3367 (U.S. Mar. 4, 1970) (judgment for \$3.2 million plus interest).

the offer involves self-dealing or conflict of interest, notably if management of the offeror has substantial holdings in the target company.⁷⁶

Another safeguard of sorts exists if securityholder approval is necessary. Examples include: (a) charter amendment to authorize additional shares, (b) New York and American Stock Exchange requirements for shareholder approval of an acquisition which increases the outstanding shares by 20 percent,⁷⁷ (c) occasional statutory provisions with the same effect,⁷⁸ (d) charter or indenture requirements for approval by senior securityholders of some kinds of acquisitions or debt increases, and (e) approval advised by counsel because of conflict of interest or importance of the transaction.

By contrast, there is usually no corporate law requirement for shareholder approval of debt securities or warrants, or for debt-security holder approval of anything. The Stock Exchanges call for a shareholder vote if new securities of any kind will be issued with a market value equal to 20 percent or more of the market value of outstanding common shares.⁷⁹

The effectiveness of securityholder approval as a safeguard is probably not very great, because of the proclivity of securityholders to vote as management recommends. However, the proxy rules will usually be applicable if the securities whose vote is sought are listed on a stock exchange *or* are held of record by as many as 500 persons.⁸⁰ The proxy rules add safeguards in the form of required disclosures⁸¹ and a general ban on false, misleading or incomplete solicitations.⁸²

Disclosure from other sources may help to protect securityholders of the offeror although it is not aimed at them. Disclosure in a

⁷⁶ *Id.* Also note the allegations under state and federal law in *Surowitz v. Hilton Hotels Corp.*, 383 U.S. 363 (1966), *rev'g* 342 F.2d 596 (7th Cir. 1965), which included a conflict of interest in the company's tender offer for its own shares and those of an affiliated company. The suit was settled by insiders agreeing to pay \$825 thousand to the offeror company. N.Y. Times, Nov. 17, 1966, at 69, col. 6; Wall Street Journal, Jan. 3, 1967, at 30, col. 2.

⁷⁷ N.Y. STOCK EXCH. CO. MANUAL A-283-84 (1963); AMERICAN STOCK EXCH. CO. GUIDE § 713 (b) (1968).

⁷⁸ OHIO REV. CODE ANN. §§ 1701.84(A), .01(R) (Page 1964).

⁷⁹ See authorities cited note 77 *supra*.

⁸⁰ Exchange Act § 14(a), 15 U.S.C. § 78n(a) (1964) (applying to registered securities; *id.* §§ 12(a), (g) (1), 15 U.S.C. §§ 78l(a), (g) (1) (1964) (the latter including a further requirement that the issuer have at least \$1 million in assets).

⁸¹ *E.g.*, SEC Exchange Act Schedule 14A, Item 14, 17 C.F.R. § 240.14a-101 (1969), *reprinted in* 2 CCH FED. SEC. L. REP. ¶ 26,871, at 20,137.

⁸² SEC Exchange Act Rule 14a-9(a), 17 C.F.R. § 240.14a-9(a) (1969), *reprinted in* 2 CCH FED. SEC. L. REP. ¶ 26,863, at 20,119.

registration statement for the securities in an exchange offer is principally for the benefit of the offerees. So is disclosure in a cash offer.⁸³ But they alert the securityholders of the offeror to negligence or conflict of interest by their management, and thus serve as an informational safeguard to them and provide a possible basis for litigation.

3. *Restraints* (2.330).— Securityholders as a group are not bound by any particular restraints.

4. *Critique* (2.340).— The securityholder of the offeror has been the forgotten man in most discussions of tender offers. But he is vulnerable to real injury, which has occurred with some frequency.⁸⁴ This raises the questions whether he should be entitled to further protections than he now has, and what these might be.

Although a tender offer is primarily a market transaction as far as the target company is concerned, it is very much a corporate transaction for the offeror. The economic and business results may be quite similar to a merger with the target company or purchase of its assets. Shareholder vote in the acquiring company is commonly required by statute for mergers but not for asset transactions unless they can be classed as *de facto* mergers.⁸⁵ If the shareholder vote affords protection, it should be applied equally to mergers, asset acquisitions and tender offers. The sensible distinction is one based on relative magnitude or quality of the transaction rather than its corporate form. Because the quality of an acquisition is so hard to factor, much less judge — involving differences in products, services, markets, finances, risk, etc. — there is no feasible way to use it as a criterion for insisting on a shareholder vote. The Stock Exchange rules appear to be on the right track in calling for shareholder action for 20 percent (or greater) increase in outstanding shares,⁸⁶ and in applying the same idea to comparable increases in value of all outstanding securities. One may argue whether 20 percent is the right figure, but it seems reasonable. Carrying the argument a step further would suggest the need for approval by other securityholders who ordinarily possess no voting rights. Probably they can be taken care of by indenture or charter provisions.

⁸³ Both are described more fully in sec. (2.721) *infra*.

⁸⁴ See note 74 *supra*.

⁸⁵ See, e.g., *Farris v. Glen Alden Corp.*, 393 Pa. 440, 143 A.2d 25 (1958).

⁸⁶ Cf. DEL. CODE ANN. tit. 8, § 251(f) (1953), *as amended*, (Supp. 1968) (dispensing with shareholder vote in a merger which increases the outstanding shares by 15 percent or less).

It is hard to believe that shareholder approval itself accomplishes very much — except protection of management — given the usual response to a management proxy solicitation. It does, however, acquaint the shareholders with the transaction, and induce management to consider their interests more carefully in shaping an offer. This benefit must be weighed against the inevitable delay, and its certain tendency to raise the price at which cash tender offers would have to be made if they were known in advance. (The problem already exists for exchange offers, mergers and asset purchases.)

Shareholder vote assumes greater significance if there is a contest. While a fight might develop among existing holders over a proposed acquisition, it is highly probable in a tender offer only if the target company (or one of its allies) takes the offensive. In short, broader shareholder approval in the offeror company would mainly give the target company a new battlefield. It is hard to justify on this basis, since the market is the more appropriate battleground.

Another sally at the problem of protection of offeror securityholders might be by calling for their ratification or retroactive approval. The odds are that this would be equally formalistic or, if the target company opposed the offer, just a rerun of the contest. Moreover, precautions would have to be devised to keep a ratification vote from becoming a device to repudiate an offer which turns out badly for the offeror.

Rather more can be said for some kind of appraisal right, of the kind given in mergers,⁸⁷ based on value preceding the announcement of the offer.⁸⁸ This would give substantial protection against offers injurious to securityholders of the offeror company. The problem would be to find a remedy that does not kill the patient. If all holders could wait for the market reaction to the offer, then claim against the offeror any drop in value of their holdings, the offeror might easily be bankrupted.

Unless their advance approval happens to be needed, there is no requirement that securityholders of the offeror be notified of

⁸⁷ For a survey of appraisal rights in different forms of corporate combination, see Note, *The Right of Shareholders Dissenting from Corporate Combination to Demand Cash Payment for Their Shares*, 72 HARV. L. REV. 1132 (1959).

⁸⁸ Some states are now denying appraisal rights for holders of actively traded securities. *E.g.*, DEL. CODE ANN. tit. 8, § 262(k) (1953), *as amended*, (Supp. 1968); Ch. 78.538, [1969] Nev. Acts. The underlying idea is reasonable: the trading market provides an objective valuation and a means of payment. But it fails to take into account an adverse market reaction to a bad merger or similar transaction.

the offer. They may, to be sure, see the newspaper ads that are directed to target securityholders or learn in other indirect ways. Even if this occurs, it may be slow, reducing the efficacy of their resort (if they so choose) to the market, which has perhaps reacted much faster and in a direction unfavorable to them. Notice by mail to holders of offeror securities would give them some slight additional protection, too late probably to use the market effectively, but perhaps soon enough to seek an injunction if there is good cause for one. Whether it would be worth the cost, particularly if copies of the prospectus had to be disseminated in an exchange offer, is open to question.

A simple informational protection could be given the securityholder of the offeror at slight cost. This would be a pro forma financial statement (including earnings per share) showing the effect of the tender offer if successful (or, more usefully, at various possible levels of success). As a matter of administrative practice, this is now required in a registered exchange offer, but need not be distributed to securityholders of the offeror. It is not required at all in a cash offer.

E. *Offeror Constituents* (2.400)

1. *Interests* (2.410).— Other constituents of the offeror may have interests in the offer, although the possibilities are too diverse to generalize very helpfully on them. For example, a supplier to the offeror may be hurt if the target company is itself a present or potential supplier, or helped if it is a potential customer. A labor union may feel the impact if a rival union represents employees in the target company. Customers of the offeror may be affected if the target company is a present or potential competitor of the offeror, or customer of it. Agencies administering the anti-trust laws are concerned too with the anticompetitive possibilities of the offer. Creditors of the offeror may be affected if its financial condition is weakened. So may debtors, less directly, by pressures to accelerate their payments.

2. *Safeguards* (2.420).— Some of these constituents may protect themselves against adverse effects of a tender offer, for example, by loan agreements or collective bargaining contracts. Some may protect themselves by suits under the antitrust laws or the labor laws. All have at least theoretical resort to the securities market (to buy or sell the securities involved in the offer or to make a counter or competing offer) and to the broader markets for

their inputs and outputs (to compensate for changes in their relations with the tender offeror). As a group they are given no protection by the corporate or securities laws. They may have some incidental protection from the disclosures required by the securities laws, *e.g.*, as to the offeror's plans for the target company.⁸⁹

3. *Restraints* (2.430).— There are no special restraints on the members of these groups, as such, relative to a tender offer.

4. *Critique* (2.440).— There is no very strong argument that these groups should have protection against tender offers. Perhaps a stronger claim can be made that they need protection against possible business changes in the wake of tender offers, but this seems sufficiently covered by contract rights, labor and antitrust law.⁹⁰

These groups, and their opposite numbers in the target company,⁹¹ offer the best argument for imposing a public interest standard on acquisitions (including tender offers) and establishing some sort of tribunal to apply it. But, in view of their other protections, such a claim seems far too weak to justify so radical a limitation.

F. *Target Company* (2.500)

1. *Interests* (2.510).— The target company's interest — as an entity distinct from its management and securityholders — is perhaps the hardest to define. In this sense a corporation has no concern with shifts in ownership of its outstanding securities. It simply acquires new owners, in the best tradition of transferable securities. The possible consequences of a change in ownership — looting and the other examples suggested earlier⁹² — are of plainer impact on the corporation. Yet change is not inherently detrimental to a corporation, and the mere possibility of change even less so. Perhaps the most that can be said here is that the corporation has a legitimate interest in any adverse economic effects that the tender offer and resulting shift in ownership may bring.

As examined later,⁹³ the tender offer gives an unusual twist to

⁸⁹ See authorities cited note 51 *supra*.

⁹⁰ I disclaim any expertise in labor and antitrust laws and must leave it to others to evaluate their adequacy as to tender offers.

⁹¹ See sec. (2.900) *infra*.

⁹² Sec. (1.400) *supra*.

⁹³ Sec. (2.610) *infra*.

the usual split between ownership (securityholders) and control (management) of the target company. In most conflicts arising from the split, the force (including economic power) of the company (wielded by its management) is pitted against the force of the shareholders, and the former prevails. In a tender offer, a new force and economic power — that of the offeror — appears and is aligned with target securityholders to the extent that it offers them money or securities for their holdings. This may reverse the usual balance, and goes far toward explaining the antipathy of some managements to tender offers.

2. *Safeguards Against Success of the Offer, and Related Restraints* (2.520).— Although it is far from clear that the target company has a justifiable interest in defeating a tender offer, let us assume that it does in order to examine the safeguards available for that purpose. Note also that they can be used to improve the offer (*i.e.*, increase the price) as well as to defeat it.

a. *Notice* (2.521).— A cash offer can, so far as federal law is concerned, be made without any notice to the target company. Various advance filings were considered in early versions of the Williams Bill, but Congress was persuaded not to enact them.⁹⁴ A target company may become aware of an impending offer by less official means, such as (a) increased trading in its securities, suggesting accumulation by a prospective offeror, (b) feelers, usually through intermediaries, about possible merger, (c) direct negotiations for board representation or acquisition, and (d) rumors. A potential offeror may be flushed out by the Williams Bill requirement that it file an ownership statement with the SEC and the target company 10 days after it acquires 10 percent of a class of target company securities.⁹⁵ It must state the purpose of its acquisition and, if it seeks control, its plans for the target company.⁹⁶

⁹⁴ For further discussion and citations to the legislative history, see A. BROMBERG, *supra* note 2, § 6.3 (421); Bromberg, *Tender Offers*, *supra* note 2, at 487-88.

⁹⁵ Exchange Act § 13(d)(1), 15 U.S.C. § 78m(d)(1) (Supp. IV, 1969). Persons acting together are lumped for the 10 percent measure. *Id.* § 13(d)(3), 15 U.S.C. § 78m(d)(3).

⁹⁶ *Id.* § 13(d)(1)(C), 15 U.S.C. § 78m(d)(1)(C); SEC Exchange Act Schedule 13D, Item 4, 17 C.F.R. § 240.13d-101 (1969), *reprinted in* 2 CCH FED. SEC. L. REP. ¶ 26,853, at 20,107-4. These do not specifically call for disclosure of intent to make a tender offer, but failure to reveal an existing plan for a tender offer might well make the statement misleading, involving possible sanctions under sections 18(a) and 32(a) of the Exchange Act [15 U.S.C. §§ 78r(a), ff(a) (1964)] and perhaps the general anti-fraud Rule 10b-5 [SEC Exchange Act Rule 10b-5, 17 C.F.R. § 240.10b-5 (1969)], and, if a tender offer shortly follows, section 14(e) of the Exchange Act [15 U.S.C. § 78n(e) (Supp. IV, 1969)]. The 10 percent ownership report required by Exchange Act § 16(a), 15 U.S.C. § 78p(a) (1964), need not be filed until the 10th of the following

Expectant tender offerors rarely cross the 10 percent line, partly to avoid this requirement, partly to avoid possible short-swing insider liability⁹⁷ if the offer fails and they choose to resell their holdings, and partly because trading market accumulation of more than 10 percent is likely to be costly, conspicuous and expensive. Thus it is not uncommon for the offeror to hold 9 or 9.9 percent when it first reveals itself to target company management for discussions. Senator Williams has introduced a bill which would reduce the filing level to 5 percent and provide an earlier warning.⁹⁸

An exchange offer normally provides ample advance warning since it must be registered with the SEC long before it becomes effective. SEC filings are public records and widely reported in the financial press. Even earlier than filing, the offeror almost invariably has to ask the target company for information about the target company to be included in the registration statement.⁹⁹

b. *Negotiations* (2.522).— If the target company has interests to protect, the effective time for it to act is before the offer ends, and before it begins if it has the opportunity. Negotiation may produce beneficial contracts or commitments from the offeror. (The target company's quid pro quo can be the securityholders list, recommendations to holders to accept the offer, or mere neutrality.) Beyond this, the target company can fight the offer in a number of ways.¹⁰⁰

c. *Communications* (2.523).— The target company has established communication channels with target securityholders and the advantage of inertia on its part. It may have special influ-

month, which will usually be later than 10 days after reaching 10 percent. And it does not have the broad "group" concept of Exchange Act § 13(d)(3), 15 U.S.C. § 78m(d)(3) (Supp. IV, 1969), by which the 10 percent level may be reached much sooner in cooperative purchases of, say, a company, its officers, and other allies.

For examples of the "group" concept in section 13(d)(3), see *Bath Indus., Inc. v. Blot*, 305 F. Supp. 526 (E.D. Wis. 1969), and, in a tender offer context, the allegations in §§ 14-15, 19-21 of the complaint in *SEC v. Madison Square Garden Corp.*, summarized in [Current Binder] CCH FED. SEC. L. REP. ¶ 92,493, at 98,306 (S.D.N.Y., filed Oct. 6, 1969).

⁹⁷ Exchange Act § 16(b), 15 U.S.C. § 78p(b) (1964).

⁹⁸ S. 3431, 91st Cong., 2d Sess. § 1(2) (1970).

⁹⁹ SEC Securities Act Form S-1, General Instructions, ¶ F, mentioned in 17 C.F.R. § 239.11 (1969), reprinted in 1 CCH FED. SEC. L. REP. ¶ 7122, at 6202; ¶ 8006, at 7015. The information on the target company may be omitted to the extent it is not available; a showing of request to obtain it is necessary. SEC Securities Act Rule 409(b), 17 C.F.R. § 230.409(b) (1969), reprinted in 1 CCH FED. SEC. L. REP. ¶ 5807, at 5093.

¹⁰⁰ See sec. (1.500) *supra*.

ence with some holders, notably those who are employees or business associates. And it may have control over some of them, *e.g.*, its subsidiaries and its profit sharing or other employee benefit trusts, sufficient to prevent them from tendering or selling.

In communicating with its securityholders the target company is limited by the antifraud provisions, mainly section 14(e) of the 1934 Act and Rule 10b-5. In addition, if the offer is not registered under the 1933 Act, the Williams Bill sharply curtails target company communication prior to an SEC filing by it. All it can say is management is studying the offer and will make a recommendation by a specified date (at least 10 days before expiration of the offer), and ask securityholders to defer decision until receiving the recommendation.¹⁰¹ The required SEC filing by the target company includes copies of the target company's recommendation, the reasons for it, data on target security transactions by the target company (and its officers, directors and affiliates) within the past 60 days.¹⁰² After filing with the SEC, the target company can say what it wants, but must include in any written recommendation much of the data filed with the SEC, especially the "reasons."¹⁰³ Stating reasons which are specific enough to be meaningful, disinterested enough to be persuasive, and honest enough to withstand the antifraud provisions is far from easy, and target companies might conceivably be deterred from saying anything by this Hobson's choice.

On the other side of the communication picture, the target company has no general obligation to give internal information to the offeror. Denying requests for data may raise obstacles to the offer.¹⁰⁴

d. *Market Operations* (2.524).— The target company can fight the offer in the trading market. This may take the form of buying target securities, for multiple purposes including raising their price above the offer price in order to discourage tenders (as well as arbitrage purchases with a view to tender), and decreas-

¹⁰¹ SEC Exchange Act Rule 14d-2(f), 17 C.F.R. § 240.14d-2(f) (1969), *reprinted in* 2 CCH FED. SEC. L. REP. ¶ 26,886A, at 20,152. For more comprehensive discussion, see A. BROMBERG, *supra* note 2, § 6.3(636); Bromberg, *Tender Offers*, *supra* note 2, at 522-23.

¹⁰² SEC Exchange Act Rule 14d-4, 17 C.F.R. § 240.14d-4 (1969), *reprinted in* 2 CCH FED. SEC. L. REP. ¶ 26,887, at 20,152. For further discussion, see A. BROMBERG, *supra* note 2, §§ 6.3(630)-(634); Bromberg, *Tender Offers*, *supra* note 2, at 519-22.

¹⁰³ SEC Exchange Act Rule 14d-4(c), 17 C.F.R. § 240.14d-4(c) (1969), *reprinted in* 2 CCH FED. SEC. L. REP. ¶ 26,887, at 20,153.

¹⁰⁴ See sec. (2.125) *supra*.

ing the shares available for tender. Many restraints operate on such purchases:

(1) There must be adequate surplus under the governing corporate law and indentures,¹⁰⁵ as well as available cash or credit.

(2) The purchases must be characterizable as a defense of corporate policy rather than of management position.¹⁰⁶ But this seldom presents a serious impediment to a thoughtful minute writer.

(3) Under the Williams Bill, and implementing SEC rules, a target company in a cash offer has an advance disclosure requirement before it can purchase any of its equity securities. In a filing with the SEC it must identify the securities to be bought; the classes of sellers and the markets to be used; the purpose of the purchase and the planned disposition of the securities; the source and amount of funds to be used and if any have been borrowed, a description of the transaction and parties. Moreover, the target company must have given the substance of the same information to its equity securityholders sometime within 6 months preceding the purchases.¹⁰⁷

The target company, persons controlling it, controlled by it, or under common control with it, and persons subject to control by any of them, are all considered part of a single group. Purchases by any of them are deemed purchases by the target company, and cannot be made before the SEC filing and notice to securityholders.¹⁰⁸ Apparently the filing must contain information on their purposes, planned disposition, fund sources, etc. The control group concept typically covers officers, directors, employees, major securityholders, and profit sharing or other employee benefit trusts controlled by the target company or its officers, directors or employees. Target company allies who join in buying its securities are classed with the target company as a single "person"¹⁰⁹ but

¹⁰⁵ See, e.g., *Israels, Limitations on the Corporate Purchase of Its Own Shares*, 22 Sw. L.J. 755, 755-58 (1968).

¹⁰⁶ Compare *Cheff v. Mathes*, 41 Del. Ch. 494, 199 A.2d 548 (Sup. Ct. 1964), and *Kors v. Carey*, 39 Del. Ch. 47, 158 A.2d 136 (Ch. 1960), with *Bennett v. Propp*, 41 Del. Ch. 14, 187 A.2d 405 (Sup. Ct. 1962). For a recent application of this theory to hold the directors of the *Denver Post* liable for purchasing its shares to defeat an offer by Samuel I. Newhouse, see *Wall Street Journal*, Mar. 9, 1970, at 21, col. 1 (Southwest ed.).

For a suggested alternative test, see sec. (2.560) *infra*.

¹⁰⁷ SEC Exchange Act Rule 13e-1, 17 C.F.R. § 240.13e-1 (1969), *reprinted in* 2 CCH FED. SEC. L. REP. ¶ 26,852, at 20,107-3. The rule takes effect only when the tender offeror files its Schedule 13D with the SEC and notifies the target company.

¹⁰⁸ Exchange Act § 13(e)(2), 15 U.S.C. § 78m(e)(2) (Supp. IV, 1969).

¹⁰⁹ *Id.* § 14(d)(2), 15 U.S.C. § 78n(d)(2) (Supp. IV, 1969).

the consequences are not very clear.¹¹⁰ Misrepresentations or omissions in the required information probably give the tender offeror standing to sue.¹¹¹ Appropriate relief would normally be an injunction against target company purchases until release of complete and accurate information.¹¹² The trickiest element of this disclosure is the purpose of the purchase. If the stated purpose is to hold the shares for employee incentives or future acquisitions, it is open to challenge that this is not the real purpose. A stated purpose of protecting the corporation against feared depredation as a result of the offer may be similarly attacked. A stated purpose of driving the market price up probably increases vulnerability to a charge of manipulation. The need to state a purpose is something of a deterrent to buying at all.¹¹³ However, similar reasons will have to be given for the target company's recommendation to securityholders to accept or reject the offer.¹¹⁴

(4) The antifraud and antimanipulative provisions of the 1934 Act may apply, although their limits are only beginning to emerge. The Court of Appeals for the Second Circuit has held

¹¹⁰ One consequence might be regulation of solicitations by the allies, but the SEC has not made any special rules for them. Any solicitor is subject to SEC Exchange Act Rule 14d-4, 17 C.F.R. § 240.14d-4 (1969), *reprinted in* 2 CCH FED. SEC. L. REP. § 26,887, at 20,152.

Another consequence might be disclosure of the allies' market activities. But the present disclosure requirement for the target company is in SEC Exchange Act Rule 13e-1, 17 C.F.R. § 240.13e-1 (1969), *reprinted in* 2 CCH FED. SEC. L. REP. § 26,852, at 20,107-3, promulgated under Exchange Act § 13(e), 15 U.S.C. § 78m(e) (Supp. IV, 1969). The latter has a separate "group" concept based on control rather than cooperation. *Id.* § 13(e)(2), 15 U.S.C. § 78m(e)(2).

A third possible consequence is the timing of the target company's disclosure requirement. Arguably, if an ally begins to buy first, its actions constitute purchases by the offeror, which must be preceded by SEC filing and communication to shareholders. But this interpretation does violence to the separation of sections 13(e) and 14(d), and their distinct lumping provisions, sections 13(e)(2) and 14(d)(2).

Another possible consequence is joint and several liability for any damages caused by violations. However, the lumping language of section 14(d)(2) is limited to "this subsection," meaning section 14(d), and presumably is inapplicable to, say, the fraud provision, section 14(e).

Additional questions arise if the allies are investment companies. *See* Thomas, *supra* note 40.

¹¹¹ *See* note 58 *supra*. A target securityholder will probably have standing too. *See* authorities cited note 178 *infra*.

¹¹² *See* text accompanying note 121 *infra*.

¹¹³ A. BROMBERG, *supra* note 2, § 6.3(642); Bromberg, *Tender Offers*, *supra* note 2, at 527.

¹¹⁴ Exchange Act § 14(d)(4), 15 U.S.C. § 78n(d)(4) (Supp. IV, 1969); SEC Exchange Act Rule 14d-4, 17 C.F.R. § 240.14d-4 (1969), *reprinted in* 2 CCH FED. SEC. L. REP. § 26,887, at 20,152; SEC Exchange Act Schedule 14D, Item 1(b), 17 C.F.R. § 240.14d-101 (1969), *reprinted in* 2 CCH FED. SEC. L. REP. § 26,889, at 20,154. *See* A. BROMBERG, *supra* note 2, § 6.3(633)(3); Bromberg, *Tender Offers*, *supra* note 2, at 519-21.

that large purchases of target securities by an ally of the target company (its proposed merger partner) violated section 9(a)(2) of the 1934 Act and Rule 10b-5.¹¹⁵ The critical aspect was that the buyer was simultaneously but secretly reselling 120,000 of the 170,000 shares it bought. The resales were to institutional investors at \$5 a share less than the purchases, and the court regarded them as deceptively distorting the supply-demand picture in the market. The court carefully refrained from holding that buying in opposition to a tender offer is by itself a violation.

(5) If the target company is currently engaged in a distribution of its securities — in acquisitions (including a deferred issue agreement calling for additional shares based on earnings or market prices), or to satisfy outstanding warrants, convertibles or employee options — it may find itself prohibited entirely from buying its own securities.¹¹⁶

Although there will rarely be enough time, a target company might make a competing tender offer for its own shares, subject generally to the same restrictions listed above.¹¹⁷

Another possible tactic in an exchange offer is to sell short the securities being offered, in hopes of driving down the price and reducing the appeal of the offer. This may fall afoul of the anti-fraud or antimanipulative provisions.

Yet another move is for the target company to make a cash offer (there will hardly be sufficient time for an exchange offer) for securities of the offeror, or to buy them in the trading markets. This raises a number of perplexities, including the chance that each will succeed and obtain control of the other.¹¹⁸

e. Disclosure Obligations and Restrictions on the Offeror (2.525).— The target company, like its securityholders, is afforded some protection by the disclosure and antifraud portions of the Williams Bill and Rule 10b-5.¹¹⁹ It has standing to sue for violations

¹¹⁵ Crane Co. v. Westinghouse Air Brake Co., 419 F.2d 787 (2d Cir. 1969).

¹¹⁶ SEC Exchange Act Rule 10b-6, 17 C.F.R. § 240.10b-6 (1969), reprinted in 2 CCH FED. SEC. L. REP. ¶ 26,745, at 20,062. For the rules of thumb which have evolved in this area, see A. BROMBERG, *supra* note 2, § 7.3; Foshay, *Market Activities of Participants in Securities Distributions*, 45 VA. L. REV. 907 (1959); Whitney, *Rule 10b-6: The Special Study's Rediscovered Rule*, 62 MICH. L. REV. 567 (1964); Comment, *The SEC's Rule 10b-6: Preserving a Competitive Market During Distributions*, 1967 DUKE L.J. 809.

¹¹⁷ See text accompanying notes 105-16 *supra*.

¹¹⁸ For one of the few cases dealing with circular control as a matter of corporate law, see *Robotham v. Prudential Ins. Co.*, 64 N.J. Eq. 673, 53 A. 842 (1903).

¹¹⁹ See sec. (2.721) *infra*.

of most or all of these provisions.¹²⁰ Appropriate relief will typically be an injunction against continuation or consummation of the offer, long enough to cure the violation, and coupled with a right to withdraw securities already tendered. A purely prohibitory injunction is unlikely to achieve the statutory objectives or the equitable requirement of interest balancing.¹²¹

If the offer is one of exchange, it will normally have to be registered under the 1933 Act, affording further informational safeguards. These include advance warning¹²² and disclosures of weakness in the offeror that can be turned into deadly publicity against the offer.¹²³ While it is not clear whether the target company has

¹²⁰ For violations of the antifraud tender provision, Exchange Act § 14(e), 15 U.S.C. § 78n(e) (Supp. IV, 1969), see *Butler Aviation Int'l, Inc. v. Comprehensive Designers, Inc.*, [Current Binder] CCH FED. SEC. L. REP. ¶ 92,557, at 98,541 (2d Cir. Jan. 8, 1970) (exchange offer); *Electronic Specialty Co. v. International Controls Corp.*, 409 F.2d 937, 944-46 (2d Cir. 1969) (cash offer). See also *Armour & Co. v. General Host Corp.*, 296 F. Supp. 470 (S.D.N.Y. 1969) (not discussing standing but entertaining a suit by the target company in an exchange offer).

For violations of the general antifraud provision, SEC Exchange Act Rule 10b-5, 17 C.F.R. § 240.10b-5 (1969), see the authorities (which are divided) collected in A. BROMBERG, *supra* note 2, § 6.3(1030) nn.58.2-4; Bromberg, *Tender Offers*, *supra* note 2, at 552-53. See also *Armour & Co. v. General Host Corp.*, *supra*. The district court found Rule 10b-5 standing in *Butler Aviation Int'l, Inc. v. Comprehensive Designers, Inc.*, [Current Binder] CCH FED. SEC. L. REP. ¶ 92,543, at 98,495 (S.D.N.Y. Dec. 24, 1969), but the Second Circuit declined to pass on this point since it agreed that there was standing under section 14(e). *Id.* [Current Binder] CCH FED. SEC. L. REP. ¶ 92,557, at 98,541 (2d Cir. Jan. 8, 1970).

For violations of the disclosure and regulatory provisions, Exchange Act § 14(d), 15 U.S.C. § 78n(d) (Supp. IV, 1969), see *Electronic Specialty Co. v. International Controls Corp.*, *supra* (cash offer); *Pan American Sulphur Co. v. Susquehanna Corp.*, [Current Binder] CCH FED. SEC. L. REP. ¶ 92,473, at 98,233 (W.D. Tex. May 28, 1969), *rev'd*, [Current Binder] CCH FED. SEC. L. REP. ¶ 92,610, at 98,749 (5th Cir. Mar. 13, 1970) (cash offer); *cf. Bath Indus., Inc. v. Blot*, 305 F. Supp. 526 (E.D. Wis. 1969) (implied standing under section 13(d), companion to section 14(d)). See also *Armour & Co. v. General Host Corp.*, *supra*.

For violation of the margin rules, Exchange Act § 7, 15 U.S.C. § 78g (Supp. IV, 1969), see *Metro-Goldwyn-Mayer, Inc. v. Transamerica Corp.*, 303 F. Supp. 1354 (S.D.N.Y. 1969) (finding, however, no violation).

¹²¹ See *Butler Aviation Int'l, Inc. v. Comprehensive Designers, Inc.*, [Current Binder] CCH FED. SEC. L. REP. ¶ 92,557, at 98,541 (2d Cir. Jan. 8, 1970) (affirming with great reluctance a flat prohibition against an exchange offer, and expressing strong preference for curative disclosure and withdrawal rights); *Electronic Specialty Co. v. International Controls Corp.*, 409 F.2d 937, 947 (2d Cir. 1969), *same case below* 296 F. Supp. 462 (S.D.N.Y. 1968) (noting that the offer was near the top of the trading market range for the target securities and that holders might never get another similar opportunity); *Metro-Goldwyn-Mayer, Inc. v. Transamerica Corp.*, 303 F. Supp. 1344, 1353-54 (S.D.N.Y. 1969) (requiring disclosure of antitrust aspects); *Armour & Co. v. General Host Corp.*, 296 F. Supp. 470, 475 (S.D.N.Y. 1969) (target security-holders should not be deprived of choice between exchange offer and cash offer). See also cases cited note 141 *infra*. For a fuller discussion, see A. BROMBERG, *supra* note 2, §§ 6.3(1100)-(1130); Bromberg, *Tender Offers*, *supra* note 2, at 555-66.

¹²² See authorities cited note 99 *supra*.

¹²³ Here are some examples:

standing to sue for violation of the 1933 Act registration requirements,¹²⁴ any violation by way of misrepresentation or nondisclosure will almost certainly violate section 14(e) of the 1934 Act, for which standing is recognized.¹²⁵ If the offeror seeks approval from its securityholders for any aspect of the offer, the proxy rules provide some of the same informational safeguards for the target company as does a registration statement. It is uncertain whether the target company has any standing to sue for misrepresentation or other violations in a proxy solicitation of the offeror's holders. Its interests may be too remote for legal protection.¹²⁶

Relief for securities violations by the offeror will commonly be a curative injunction, but can be more thoroughgoing.¹²⁷

Although without formal standing to initiate SEC action, the target company may confer with the SEC and request it to take in-

Wall Street Journal, May 19, 1969, at 21, col. 1 (Southwest ed.) ("Why B.F. Goodrich Doesn't Need Northwest" — stressing losses of Northwest and favorable earnings prospects of Goodrich, and quoting from Northwest's registration statement a paragraph on uncertainties in its ability to pay interest and dividends).

Wall Street Journal, Jan. 28, 1969, at 21, col. 3 (Southwest ed.) ("Sharon [Steel] Stockholders, Your Board Urges You to Accept the Cyclops Offer: Four Dangers in NVF's Offer" — listing insufficient earnings of NVF to pay interest on the debentures being offered, bookkeeping changes made to keep NVF from reporting a loss, NVF's uncertain future (quoted from its prospectus), and its desire to use target company's resources to bail itself out).

Wall Street Journal, Jan. 9, 1969, at 15, col. 1 (Southwest ed.) (Armour quoting at length from General Host's registration statement).

Perhaps the ultimate in this line is reported in Wall Street Journal, July 1, 1969, at 11, col. 1 (Southwest ed.) ("World's First Comic Prospectus, Read about 'Funny Money,' How Emerson Turned the Profit Corner and Other Factual but Hilarious Stuff" — National Presto Industries quoting at length from National Union Electric's prospectus on such subjects as the offeror's earnings decline and dependence on government contracts, the taxability of the transaction, and the expenses of the offer).

¹²⁴ Compare *Symington Wayne Corp. v. Dresser Indus., Inc.*, 383 F.2d 840, 842 (2d Cir. 1967) (indicating that standing of target company is an open question, and denying relief on other grounds), with *Chris-Craft Indus., Inc. v. Bangor Punta Corp.*, [Current Binder] CCH FED. SEC. L. REP. ¶ 92,510, at 98,372 (2d Cir. Nov. 6, 1969) (finding violation in suit by rival exchange offeror without discussion standing).

¹²⁵ See cases cited note 120 *supra*. *Armour & Co. v. General Host Corp.*, 296 F. Supp. 470 (S.D.N.Y. 1969), included claims of violation of section 17(a) of the Securities Act, 15 U.S.C. § 77q(a) (1964). As stated, the court permitted the suit without discussion of standing.

¹²⁶ *But cf.* *Mills v. Electric Auto-Lite Co.*, [Current Binder] CCH FED. SEC. L. REP. ¶ 92,556, at 98,532 (U.S. Jan. 20, 1970), holding that a shareholder whose proxies are being solicited establishes a violation by showing the materiality of the misrepresentation or omission, without any need to prove that it caused the transaction in question, *i.e.*, merger into the parent. Since the proxy rules are designed for the benefit of the solicitees, there is more justification for easing their right to sue than the right of another corporation indirectly affected by the outcome of the solicitation. See also text accompanying notes 65-66 *supra*.

¹²⁷ See text accompanying notes 121 *supra*, 141 *infra*.

formal or formal steps against the offeror.¹²⁸ Similar addresses may be made to other federal or state agencies having jurisdiction.¹²⁹

Some of the required terms of a cash tender offer, while intended to benefit the target securityholders, also help the target company. The 10-day minimum duration of an offer, and the requirement that tenders made during this period be taken up pro rata¹³⁰ (rather than first-come-first-served) give the target company more time to oppose the offer, and let it urge its securityholders not to be stampeded into tendering. The right to withdraw tenders for the first 7 days of the Offer Period¹³¹ may allow the target company to induce the revocation of some tenders that have already been made, although it will rarely be able to act fast enough to accomplish this.

f. *Antitrust Laws* (2.526).— The antitrust laws are designed to preserve competition. In particular, section 7 of the Clayton Act¹³² bars an acquisition if its effect may be substantially to lessen competition or to tend to create a monopoly. A target company has standing to sue and may obtain, on appropriate showing, varying degrees of injunctive relief against an anticompetitive tender offer.¹³³ So, of course, may the government.¹³⁴

¹²⁸ For a description of one series of target company efforts at the SEC in opposition to an exchange offer registration, see *Armour & Co. v. General Host Corp.*, 296 F. Supp. 470, 472-75 (S.D.N.Y. 1969). For a formal SEC proceeding against a cash offer filing, see *In re Susquehanna Corp.*, [Current Binder] CCH FED. SEC. L. REP. ¶ 77,741, at 83,692 (SEC Hearing Examiner Aug. 5, 1969). There is no indication what role the target company played in obtaining the hearing.

¹²⁹ See *Northwest Industries, Inc.*, Prospectus, at 8-9 (Apr. 16, 1969) (recounting ICC proceedings); Proposed Exchange Offer by Northwest Industries, Inc. of Certain Debentures, Preferred Stock, and Warrants to Holders of Shares of Common Stock, of the B. F. Goodrich Co., reprinted in CCH BLUE SKY L. REP. ¶ 70,816, at 66,824 (Ohio Dep't of Commerce, Div. of Securities, May 1, 1969); Offer by General Host Corp. for Common Stock and Debentures of Armour & Co., reprinted in CCH BLUE SKY L. REP. ¶ 70,805, at 66,808 (Wis. Comm'r of Securities, Feb. 10, 1969).

¹³⁰ Exchange Act § 14(d)(6), 15 U.S.C. § 78n(d)(6) (Supp. IV, 1969), sets the 10-day pro rata take-up period, which effectively requires a minimum Offer Period of 10 days. However, the provision, by its own terms, does not apply to an offer for all securities tendered, since the offeror is not discriminating among early and late tenders. See A. BROMBERG, *supra* note 2, §§ 6.3(530)-(540); Bromberg, *Tender Offers*, *supra* note 2, at 509-13.

¹³¹ Exchange Act § 14(d)(5), 15 U.S.C. § 78n(d)(5) (Supp. IV, 1969); A. BROMBERG, *supra* note 2, §§ 6.3(520)-(524); Bromberg, *Tender Offers*, *supra* note 2, at 506-08.

¹³² Clayton Act, ch. 25, § 7, 38 Stat. 731 (1914), as amended, 15 U.S.C. § 18 (1964).

¹³³ *Metro-Goldwyn-Mayer, Inc. v. Transamerica Corp.*, 303 F. Supp. 1344 (S.D.N.Y. 1969) (cash offer financed by competitor of target company). *But see Lunkenheimer Co. v. Condec Corp.*, 268 F. Supp. 667 (S.D.N.Y. 1967). MGM's relief was short lived; the offeror quickly found financing from a non-competitor and the offer proceeded. See 303 F. Supp. at 1354.

Acquisition by the target company of a competitor of the offeror, or merger of the target company into such a competitor, may force the offeror to give up.¹³⁵

g. *Delay (2.527)*.— Stalling actions by the target company can be highly protective.¹³⁶ They may permit it to merge with a friendly company or obtain a tender offer from one. Delay may dissuade the offeror, especially in a cash offer with large commitment fees which mount day by day with receding prospects of success, or in an exchange offer during a declining market. Delay will probably discourage arbitrageurs, inclining them not to buy, and to sell the target securities they own; the first action reduces the prospects of the offer, and the second may have a similar effect.

The main techniques of delay are administrative and legal proceedings of the kind discussed elsewhere.¹³⁷

3. *Safeguards Against Assumption of Control (2.530)*.— Various devices can be designed by the target company to thwart the assumption of control by a successful offeror. These usually focus on the nerve center of the corporation, the board of directors, and operate to delay or prevent target company representatives from coming onto the board. A mild technique (which many companies already use) gives the existing board, even though less than a quorum, the power to fill any vacancies which may exist from death or resignation. This helps if directors are frightened, by the offer, into quitting. To keep the offeror from exercising its shareholder voting power to remove existing directors, it may be provided that removal shall be only for cause, with elaborate and slow procedures for determining cause. To keep the offeror from taking board control through its voting power at the next regular election, the board, in most states, can be staggered so that only one-third of its directors (or perhaps even a smaller fraction) come up for election each year.¹³⁸ Elections can be delayed for awhile by failing to call the annual meeting. Management retention of the proxy machinery might even keep the offeror (if it owns less than a majority of the vote) from winning the seats that are up for contest. Stag-

¹³⁴ *United States v. International Tel. & Tel. Corp.*, 306 F. Supp. 766 (D. Conn. 1969); *United States v. Northwest Indus., Inc.*, 301 F. Supp. 1066 (N.D. Ill. 1969). For the character of these decrees, see note 8 *supra*.

¹³⁵ *Cf. Crane Co. v. Westinghouse Air Brake Co.*, 419 F.2d 787 (2d Cir. 1969).

¹³⁶ See Herzl, *Strategy and Tactics in Stockholder Litigation*, 15 PRAC. LAW. 65, 66-70 (No. 5, May 1969); 11 CORP. PRAC. COMMENTATOR 364, 365-71 (1969).

¹³⁷ See text accompanying notes 121, 128-29 *supra*, note 141 *infra*.

¹³⁸ *E.g.*, ABA-ALI MODEL BUS. CORP. ACT § 35 (1967).

gered terms dilute the effectiveness of the offeror's holdings if there is cumulative voting which might otherwise give it a minority of the seats being contested. And cumulative voting itself can be eliminated in most states.¹³⁹

The devices just described can be in the charter or bylaws, or both, depending on the applicable statute. To keep them from being undermined, they need reinforcement by appropriate restrictions on amendments. For example, it might be provided that the bylaws may be amended only by the directors, or that certain charter provisions can be changed only by a vote considerably higher than the offeror controls through ownership.

Other obstacles to assumption of control (and, indeed, to the success of the offer) include provisions in loan agreements or indentures. Changes of board control, or acquisition by a person or group of more than a designated percentage of the outstanding shares, can be defined as events of default, accelerating the debt unless waived by the creditor.¹⁴⁰

Arrangements of this sort have their obvious problems of rigidifying the corporation and appearing to serve the selfish interests of management rather than the interests of the corporation. And they can be harmful to the corporation if, despite their deterrent effect on tender offers, an offer is made and the corporation is suddenly faced with a large current liability.

If the offeror has committed violations, a court has broad discretion in imposing sanctions. On an appropriate showing of irreparable injury to the target company (or its securityholders) and balance of equities, a court may enjoin voting of shares acquired by the offeror.¹⁴¹ However, the injunction is likely to be temporary.¹⁴² Much the same is true for antitrust violations, although the injunction may be longer because of the complexity of trial on the merits.¹⁴³

¹³⁹ See, e.g., *Janney v. Philadelphia Transp. Co.*, 387 Pa. 282, 128 A.2d 76 (1956).

¹⁴⁰ See Note, *Defensive Tactics Employed by Incumbent Managements in Contesting Tender Offers*, *supra* note 11, at 1109.

¹⁴¹ *Pan American Sulphur Co. v. Susquehanna Corp.*, [Current Binder] CCH FED. SEC. L. REP. ¶ 92,473, at 98,233 (W.D. Tex. May 28, 1969), *rev'd* [Current Binder] CCH FED. SEC. L. REP. ¶ 92,610, at 98,749 (5th Cir. Mar. 13, 1970); *cf. Bath Indus., Inc. v. Blot*, 305 F. Supp. 526 (E.D. Wis. 1969) (group of securityholders preliminarily enjoined from proceeding with plans to take control; failure to file information required by Exchange Act § 13(d), 15 U.S.C. § 78m(d) (Supp. IV, 1969), a part of the Williams Bill similar to Exchange Act § 14(d), 15 U.S.C. § 78n(d) (Supp. IV, 1969) (no tender offer involved). For remedies available to the offeror, see authorities cited note 59 *supra*.

¹⁴² See cases cited note 121 *supra*.

¹⁴³ See note 8 *supra*. An agreement between the government and the offeror led

If the offeror has committed securities violations, the target company may have a basis in the Uniform Commercial Code for refusing to register transfer of securities to the offeror.¹⁴⁴ The purpose would be to deny the offeror the voting and distribution rights of a registered holder of target securities.¹⁴⁵ But the target company gets little protection here, since the thrust of the law is to facilitate transfers rather than to impede them.¹⁴⁶ Moreover, the offeror can beat this game by soliciting proxies with tenders.

4. *Safeguards Against Economic Injury* (2.540).— The target

to a voting trust for LTV's holdings in Jones & Laughlin. *United States v. Ling-Temco-Vought, Inc.*, Civil No. 69-438 (W.D. Pa., filed April 14, 1969), summarized in 5 Trade Reg. Rep. ¶ 45,069, at 52,712 (Case 2045). A year later a new agreement allowed LTV to take control on divesting itself of other companies. Wall Street Journal, Mar. 9, 1969, at 26, col. 1 (Southwest ed.). See further discussion in note 8, *supra*.

¹⁴⁴ One possible basis is Uniform Commercial Code § 8-306(a)(2) [hereinafter cited as UCC], by which a transferor (the tendering holder of target securities) warrants that his transfer (to the tender offeror) is "rightful." This has been construed to mean compliance with the securities laws, but mainly the 1933 Act registration requirements. See C. ISRAELS & E. GUTTMAN, MODERN SECURITIES TRANSFER 404-07 (1967). It is arguable, but not decided, that fraud or statutory securities violations by a transferee (tender offeror) make the transfer wrongful in this context. Whether the issuer (target company) can use a transferor's (tendering securityholder's) warranty against the transferee (tender offeror) is questionable. However, by a more immediately pertinent provision, the issuer is obligated to register transfer only if the transfer is in fact "rightful" or is to a "bona fide purchaser." UCC § 8-401(1)(e). The first term is undefined, but may, as noted above, relate to securities violations. Bona fide purchaser is defined as a buyer (tender offeror) for value "in good faith and without notice of any adverse claim." UCC § 8-302. Although the emphasis is on ignorance of claims of third parties, it is broad enough to deny bona fide purchaser status to the buyer (tender offeror) who is guilty of misconduct. Good faith means honesty in fact in the conduct or transaction concerned, *i.e.*, the tender offer. UCC § 1-201(19).

An alternative basis for refusing registration of transfer is that violations by the offeror may create adverse claims of tendering holders. By UCC § 8-306(1), the presenter (*i.e.*, the offeror or agent) warrants that he is entitled to registration. This means there are no adverse claims that the transfer is wrongful under UCC § 8-301(1) because of a violation of the Securities Act of 1933. C. ISRAELS & E. GUTTMAN, *supra* at 904, 1202. Normally the target company (issuer) has an obligation to register transfer if it has *no* duty to inquire into adverse claims. UCC § 8-401(1)(c). Such a duty exists if (and apparently only if) it has received timely written notice or if it is charged with notice from other documents it has acquired, an unlikely eventuality in a tender offer. UCC § 8-403(1). Moreover, the notice language in UCC § 8-403(1)(a), seems to embrace only an individual's claim on particular securities, thus precluding a "class" notice by a cooperative securityholder for himself and all other tendering holders. Constructive or actual notice from observed violations is probably not notice for UCC purposes. See UCC § 8-403(3); C. ISRAELS & E. GUTTMAN, *supra* at 1210-11.

¹⁴⁵ See UCC § 8-207(1).

¹⁴⁶ The issuer may be liable for refusal to register or for unreasonable delay. UCC § 8-401(2); C. ISRAELS & E. GUTTMAN, *supra* note 144, at 902-03, 1219-21. Even if there is notice of adverse claims, the issuer has only limited time in which to investigate them and decide on its course of action. In effect, the burden shifts to the claimant (tendering securityholder) to prevent the transfer by court order. UCC § 8-403(2); C. ISRAELS & E. GUTTMAN, *supra* note 144, at 1211-14.

company has little practical recourse against economic injury by the offeror if the latter takes control. However, it has theoretical causes of action for waste, mismanagement and fiduciary breach, which may be asserted derivatively by a shareholder or by a bankruptcy trustee or receiver. They may or may not be effective, depending on the facts, the parties, the amount involved and many other variables.

By advance planning the target company can create some obstacles to economic injury by a controlling securityholder. High shareholder voting requirements for a merger with a substantial shareholder may bar a disadvantageous combination.¹⁴⁷ Bans on all conflict of interest transactions, particularly loans and maybe even extraordinary dividends, may be written into the charter. (For such provisions to be meaningful, they must be amendable only by a comparably high vote.) Similar provisions can be inserted in loan agreements or indentures where they may carry greater leverage and be harder to change. Techniques of this kind can backfire by preventing the target company from making economically desirable transactions.

The target company has a degree of practical protection deriving from the probability that the offeror, having bought it, will want to help it rather than hurt it.

The target company lacks any very effective recourse against actions of an unsuccessful offeror which depress the market value of target securities. The existence of a cause of action is in doubt, there are difficult elements of proof if causation is strictly enforced, and the target company may not have standing to sue unless some "manipulative acts in connection with any tender offer"¹⁴⁸ can be shown.

5. *Critique* (2.550).— It is hard to find gaps in the target company's safeguards. A number of restrictions operate on it, but these seem, with one exception, to strike a reasonable balance. The exception is the inability to launch an immediate communications counterattack to a surprise offer. The advance filing with the SEC¹⁴⁹ may hamper the target company more than it helps anyone that benefits by such a requirement.

If anything, the target company is overprotected by the combina-

¹⁴⁷ One may question whether a merger is disadvantageous to a corporation as distinct from its securityholders, its creditors or some of its other constituents. I will not try to answer that question here.

¹⁴⁸ Exchange Act § 14(e), 15 U.S.C. § 78n(e) (Supp. IV, 1969).

¹⁴⁹ See text accompanying notes 101-02 *supra*.

tion of control of its own structure, corporate law and securities law.

The safeguards given a target company by the specific disclosure and filing mandates of the Williams Bill are not available for an insurance company unless the securities sought in the offer are listed on a national exchange or are voluntarily registered under the 1934 Act. This is the combined result of the Williams Bill's limitation to registered securities,¹⁵⁰ and the exemption from registration procured by the insurance industry in 1964,¹⁵¹ when most publicly held over-the-counter-companies were required to register. Some states have passed laws to protect insurance companies from takeovers,¹⁵² and Senator Williams offered a 1970 amendment to include them in the federal law.¹⁵³ Whether they should have the benefit of federal law without its burdens is open to debate. A better argument can be made in behalf of their shareholders than in behalf of the companies themselves.

6. *A Suggested Corporate Law Test of Opposition Moves* (2.560).— Since a tender offer is an offer to target securityholders via the market, I submit that the proper test for judging defensive actions as a matter of corporate law is not the traditional one of corporate policy rather than personal position.¹⁵⁴ Rather, it should be whether the defensive action is reasonably calculated to benefit shareholders in a market sense, that is, higher values for their securities. Actions to obtain a higher offer, from the tender offeror or another party, are appropriate by this standard. So are stock splits and increases in the regular dividend rate. Short-term market operations destined to defeat the offer are not. Nor, probably, are increases in outstanding shares which are unlikely to produce a better offer but only to defeat the pending one. On the other hand, share increases which will raise earnings per share may pass the test.¹⁵⁵ These might be acquisitions of operating businesses whose

¹⁵⁰ Exchange Act § 14(d)(1), 15 U.S.C. § 78n(d)(1) (Supp. IV, 1969).

¹⁵¹ Exchange Act § 12(g)(2)(G), 15 U.S.C. 78l(g)(2)(G) (1964). For the background, see W. CARY, *POLITICS AND THE REGULATORY AGENCIES* 113-17 (1967).

¹⁵² Conn. Pub. Act. No. 44 (1969); 40 PA. STAT. ANN. tit. 40, § 459-6 (Supp. 1969). For an application of the former, see the IT&T-Hartford Fire acquisition described in note 8 *supra*.

¹⁵³ S. 3431, 91st Cong., 2d Sess §§1(1), 2(1) (1970).

¹⁵⁴ See cases cited note 106 *supra*.

¹⁵⁵ See *Northwest Indus., Inc. v. B.F. Goodrich Co.*, 301 F. Supp. 706, 709 (N.D. Ill. 1969). Goodrich, under the impetus of an exchange offer by Northwest, proposed to issue 700 thousand of its shares to Gulf Oil Corp. for Gulf's half-interest in Goodrich-Gulf Chemicals, Inc., a jointly owned subsidiary. In denying (after an evidentiary hearing) a preliminary injunction against the issuance, the court relied primarily on

earnings are higher per share of consideration issued than the target company is currently earning. Or they might be issues for cash if there is convincing evidence that the cash can be used in the target company to increase total earnings proportionally more than the increase in outstanding shares.

The proposed test will not always be able to discriminate between offer-defeating and value-enhancing proposals, since some actions may perform both functions. But it is a good deal more relevant than the present test.

The suggestion is essentially a fiduciary test, but pointed to the ultimate beneficiaries for whom the fiduciaries are supposed to be acting — the target securityholders — rather than to the target company as an entity. Like other fiduciary tests, the burden of proof should be on the fiduciaries. The test would not, however, preclude reference to the interests of other securityholders of the target company or its other constituents, although these will usually be of less importance.

G. *Target Company Management* (2.600)

1. *Interests* (2.610).— In part, the interests of target company management are those of the target company, discussed above,¹⁵⁶ and of its securityholders, discussed later.¹⁵⁷ Ordinarily, what is good for one is good for the other, particularly a rise in market value of the company's securities. But a striking feature of the tender offer is its capacity to drive an economic wedge between target management and target securityholders. What is good, at least in the short run, for the latter (a high value leading them to tender) may be bad for the former. Members of management are threatened with loss of their jobs and salaries, perhaps their stock options and profit sharing plans. With these go power and prestige. Even in favorable instances, they may be relegated to subordinate positions in a larger corporate complex. Their personal interests may conflict sharply with the interests of the target company and its securityholders.

But there can be real difficulty in untangling the corporate and personal interests. Management will naturally identify its programs and policies, and its achievements and plans with the welfare

the business judgment rule but made something of the point that earnings per share would rise 15 cents.

¹⁵⁶ Sec. (2.510) *supra*.

¹⁵⁷ Secs. (2.710), (2.810) *infra*.

of the corporation (and its securityholders, employees and other constituents).¹⁵⁸ More objectively, in all but the most grievous cases, there is some corporate value in continuity of management and the resulting stability.

In administering the antifraud and disclosure provisions, Judge Friendly has admonished the courts against frustrating the desires of tendering securityholders at the instance of incumbent management.¹⁵⁹

2. *Safeguards* (2.620).— The safeguards of target company management are essentially those of the target company, described earlier.¹⁶⁰ Additionally, the management may have long-term contracts assuring their compensation and perhaps their status as officers. Their positions as directors are not ordinarily a matter of contract, but can to some degree be preserved by provisions in the corporate charter¹⁶¹ or agreements between the target company and its creditors.

3. *Restraints* (2.630).— The principal restraint on target company management is that it is supposed to put corporate and shareholder interests above its own — a duty of loyalty.¹⁶² Moreover it has some duty of care to make a reasonable investigation and have a reasonable basis for its actions.¹⁶³

The courts, mainly using the business judgment rule, have been hesitant to override management.¹⁶⁴

A further discussion of the restraints on target company management appears later.¹⁶⁵

4. *Critique* (2.640).— The management of the target com-

¹⁵⁸ See, e.g., *Cheff v. Mathes*, 41 Del. Ch. 494, 199 A.2d 548 (Sup. Ct. 1964), where the buyout of a reputed raider was justified partly on the ground of the threat he posed to the company's sales force and policy. On the validity of that policy, which included deceptive trade practices, see *Holland Furnace Co.*, 55 F.T.C. 55 (1958), and the later history recounted in W. CARY, *CASES AND MATERIALS ON CORPORATIONS* 691-93 (4th ed. unabridg. 1969).

¹⁵⁹ *Butler Aviation Int'l, Inc. v. Comprehensive Designers, Inc.*, [Current Binder] CCH FED. SEC. L. REP. ¶ 92,557, at 98,543 (2d Cir. Jan. 8, 1970); cf. *Electronic Specialty Co. v. International Controls Corp.*, 409 F.2d 937, 947 (2d Cir. 1969).

¹⁶⁰ Secs. (2.520)-(2.540) *supra*.

¹⁶¹ See sec. (2.530) *supra*.

¹⁶² See generally W. KNEPPER, *LIABILITY OF CORPORATE OFFICERS AND DIRECTORS* 7-10, 74-78 (1969).

¹⁶³ *Condec Corp. v. Lunkenheimer Co.*, 43 Del. Ch. 353, 230 A.2d 769 (Ch. 1967).

¹⁶⁴ See, e.g., *Northwest Indus., Inc. v. B.F. Goodrich Co.*, 301 F. Supp. 706, 711-13 (N.D. Ill. 1969) (N.Y. law); *Cheff v. Mathes*, 41 Del. Ch. 494, 199 A.2d 548 (Sup. Ct. 1964). But see *Condec Corp. v. Lunkenheimer Co.*, 43 Del. Ch. 353, 230 A.2d 769 (Ch. 1967). See generally Ar buckle, *The Continuing Viability of the Business Judgment Rule as a Guide for Judicial Restraint*, 35 GEO. WASH. L. REV. 652 (1967).

¹⁶⁵ Sec. (2.740) *infra*.

pany is well protected by economic, legal and structural safeguards. Nothing seems to be wanting in this regard. Rather, the restraints on them are, in practice, often inadequate to deal with self protection cloaked as corporate or shareholder protection.

H. *Target Securityholders* (2.700)

1. *Interests and Alternatives* (2.710).— The interest of holders of target securities are essentially investment interests. They are forced to make a prompt, complex and usually unanticipated decision that may importantly affect their holdings. They have to face three basic alternatives: hold, sell or tender.

a. *Hold* (2.711).— They may retain their target securities. Their future is in some doubt since they may wind up as minority holders in a subsidiary controlled by the offeror. They may be squeezed out through a later merger, liquidation or recapitalization. Even if they continue, they may be apprehensive about how well minority holders will fare in the subsidiary, or how well the subsidiary will fare in view of possible business or management changes.¹⁶⁶ Moreover, their securities will probably be less marketable because of fewer public holders, resulting in stock exchange delisting or market maker indifference. Their securities may well decline in value after the Offer Period.

b. *Sell* (2.712).— They may sell in the trading market, taking a known sum. If this is more than their cost, they face an income tax (at long-term capital gain rates except for holdings of less than 6 months, or in brokers' trading accounts)¹⁶⁷ and a choice among reinvestment opportunities. They run the risk that the offer price will be increased, or that the target securities will rise in value after the offer.

c. *Tender* (2.713).— They may tender pursuant to the offer. None, some, or all of the tenders may be accepted, depending on the terms of the offer, the total number of tenders and, perhaps, the discretion of the offeror (for example, to take more or less than the minimum bid for). To the extent tenders are accepted, in an exchange offer, they have securities of a new and perhaps radically different issuer. If their tenders are partially taken up, they have fragmentary holdings of two securities. (Any rejected parts may be sold in the market, but by the time the takeups usually become known, in the Post-Offer Period, the price may have

¹⁶⁶ For a discussion of some of the possible changes, see sec. (1.400) *supra*.

¹⁶⁷ See note 45 *supra*.

dropped significantly.) The taking up of tenders precipitates a tax for the holder if it is a cash offer.¹⁶⁸ The same is true of an exchange offer unless it offers solely voting stock and the offeror winds up with at least 80 percent of the target company's voting power and 80 percent of any nonvoting shares.¹⁶⁹ There is the further uncertainty, in an exchange offer, about the future value of the offered securities.

The holder of target securities is thus interested in the terms of the offer, the offeror's ability to perform (with respect to its financial capacity and to obstacles erected by target management) and its plans for the target company, and must make judgments about the relative present and future values of the securities involved and his own financial and tax status.

In addition, holders of target securities may have psychological loyalties to the management or to the target corporate entity (particularly if they are also employees) which they see threatened by the offer. Their views toward the offeror operate more paradoxically. If they are impressed by the offeror and the prospects it holds out for the target company, they are motivated to hold their securities in order to enjoy the expected benefits. If enough holders do this, the offer fails. Conversely, if they are frightened or alienated by the offeror, they are likely to get out while the getting is good, by tendering or by selling in the trading market (probably to arbitrageurs); either disposition helps to assure the success of the offer.

Target securityholders in a tender offer may also be deciding who will manage the target company.¹⁷⁰ But this is of less import to them as individuals than their investment decisions. If they sell or tender, they are giving up their concern for the target company along with their ownership of it.

Particular securityholders who are also part of the management (or feel that they are) or have other special relations with the company will have interests and concerns in these capacities. These are considered elsewhere.¹⁷¹

2. *Safeguards in Investment Decision (2.720).*— Since the target securityholder's big problem is a fast investment decision, the most important safeguards for him are those which pertain to his decision. These take several forms.

¹⁶⁸ See sec. (2.124) *supra*.

¹⁶⁹ For a discussion of some of these tax effects, see sec. (2.124) *supra*.

¹⁷⁰ See Swanson, *supra* note 20, at 470-72.

¹⁷¹ Secs. (2.600) *supra*, (2.900) *infra*.

a. *Information* (2.721).— One important set of safeguards is informational, and comes from the Williams Bill in a cash offer¹⁷² and from the 1933 Act in an exchange offer.¹⁷³ The principal disclosures required are:

- (1) The identity of the offeror.
- (2) The terms of the offer.
- (3) The source of financing if it is a cash offer.
- (4) Complete financial data on the offeror and (so far as available to the offeror) comparable data on the target company in an exchange offer.
- (5) The offeror's purposes and plans for the target company.¹⁷⁴
- (6) The offeror's ownership of, and rights to acquire, target securities, and its trading in them in the 60 days before the offer.
- (7) Arrangements and understandings as to target securities, such as joint ventures, options, proxies and guaranties against loss.
- (8) Similar information, at least in a cash offer, for each member of any "group" acting with the offeror in the offer and each of the offeror's officers, directors and controlling persons.¹⁷⁵

¹⁷² Exchange Act § 14(d)(1), 15 U.S.C. § 78n(d)(1) (Supp. IV, 1969); SEC Exchange Act Rule 14d-1(c), 17 C.F.R. § 240.14d-1(c) (1969), *reprinted in* 2 CCH FED. SEC. L. REP. ¶ 26,885, at 20,151 (referring to SEC Exchange Act Schedule 13D, 17 C.F.R. § 240.13d-101 (1969), *reprinted in* 2 CCH FED. SEC. L. REP. ¶ 26,853, at 20,107-4). For detailed examination, see A. BROMBERG, *supra* note 2, §§ 6.3(400)-(418), (450)-(468); Bromberg, *Tender Offers*, *supra* note 2, at 482-87, 493-502.

Broadly speaking, the Williams Bill covers cash offers for 2 percent or more of a class of equity securities registered under the Exchange Act, if the offeror would then own 10 percent or more of the class. Exchange Act §§ 14(d)(1), (8), 15 U.S.C. § 78n(d)(1), (8) (Supp. IV, 1969). Registered securities are those traded over the counter (if held of record by 500 or more persons and if the issuer has assets of \$1 million or more) and those listed on stock exchanges. *Id.* §§ 12(a), (g), 15 U.S.C. §§ 78l(a), (g) (1964). For the exemption of insurance companies see *id.* § 14(d)(1), 15 U.S.C. § 78n(d)(1) (Supp. IV, 1969); *id.* § 12(g)(2)(G), 15 U.S.C. 78l(g)(2)(G) (1964). Equity securities are any but straight debt securities. *Id.* § 3(a)(11), 15 U.S.C. § 78c(a)(11) (1964). For details on the coverage of the Williams Bill, see A. BROMBERG, *supra* note 2, §§ 6.3(300)-(333); Bromberg, *Tender Offers*, *supra* note 2, at 474-82.

¹⁷³ Securities Act § 7 & Schedule A, 15 U.S.C. §§ 77g, aa (1964); SEC Securities Act Form S-1, General Instructions, ¶ F, *mentioned in* 17 C.F.R. 239.11 (1969), *reprinted in* 1 CCH FED. SEC. L. REP. ¶ 7122, at 6202; ¶ 8006, at 7015. For more detailed examination, see Bromberg, *Exchange Offers*, *supra* note 2, at 808-09; MacLean, *SEC Registration and Filing Requirements for Mergers and Acquisitions*, 4 MERGERS & ACQUISITIONS 33, 41-44 (No. 2, Mar.-Apr. 1969).

Many of the Williams Bill terms and disclosure requirements are inapplicable to registered exchange offers, but are usually complied with voluntarily under pressure from the SEC staff examining the registration statement.

¹⁷⁴ See text accompanying note 51 *supra*.

¹⁷⁵ Exchange Act § 14(d)(2), 15 U.S.C. § 78n(d)(2) (Supp. IV, 1969); SEC Exchange Act Rule 14d-1(a), (c)(4), 17 C.F.R. §§ 240.14d(a), (c)(4) (1969), *reprinted in* 2 CCH FED. SEC. L. REP. ¶ 26,886 at 20,151 (referring to SEC Exchange Act Schedule 13D, 17 C.F.R. § 240.13d-101 (1969), *reprinted in* 2 CCH FED. SEC. L. REP.

There is a requirement that comparable information filed with the SEC be corrected by amendment when material changes occur during the Offer Period.¹⁷⁶ There is no express requirement that target securityholders be notified of the change, even though it is common knowledge that few tenders are made until the end of the offer or the end of the pro rata period. Failure to publicize material changes in the information in the offer may violate the anti-fraud provisions when tenders are made on the basis of previously circulated information which has become misleading.

The antifraud provisions help to assure the accuracy and completeness of the disclosure, and to give suitable relief if there is material misrepresentation or omission. They extend not only to the offer itself and accompanying publicity and solicitation, but to earlier acts, like earnings forecasts or interim earnings reports, which may influence target securityholders.¹⁷⁷ The target company securityholders probably have standing to sue, whether or not they have tendered.¹⁷⁸

The SEC has diverse powers to use against violations of the disclosure and antifraud provisions of the 1933 and 1934 Acts.¹⁷⁹

b. *Market Yardstick* (2.722).— The trading market itself is a safeguard to the target securityholder; he can utilize it to sell his holdings. At another level, it provides the primary yardstick for his investment decisions: the market performance, past and present, of the target security and of any securities being offered (if the latter have a market history).¹⁸⁰ There is no requirement that this information be furnished in a cash offer (but it is sometimes given voluntarily), although as a matter of administrative

§ 26,853, at 20,107-4, of which Note B and Item 5 are relevant). For further discussion of the "group" concept, which is also found verbatim in Exchange Act § 13(d)(3), 15 U.S.C. § 78m(d)(3) (Supp. IV, 1969), enacted simultaneously, see note 96 *supra* and text accompanying notes 109-10 *supra*.

¹⁷⁶ SEC Exchange Act Rule 14d-1(b), 17 C.F.R. § 240.14d-1(b) (1969), *reprinted in* 2 CCH FED. SEC. L. REP. § 26,886, at 20,151.

¹⁷⁷ See *Butler Aviation Int'l, Inc. v. Comprehensive Designers, Inc.*, [Current Binder] CCH FED. SEC. L. REP. § 92,557, at 98,543 (2d Cir. Jan. 8, 1970) (expressing doubt about the materiality of the particular statements to the exchange offer, but sustaining an injunction). See also text accompanying notes 60-62 *supra*.

¹⁷⁸ *Kahan v. Rosenstiel*, [Current Binder] CCH FED. SEC. L. REP. § 92,589, at 98,685 (3d Cir. Feb. 20, 1970); A. BROMBERG, *supra* note 2, §§ 6.3(1020)-(1023); Bromberg, *Tender Offers*, *supra* note 2, at 549-51.

¹⁷⁹ E.g., Securities Act § 8(d), 15 U.S.C. § 77h(d) (1964) (stop order for registration statement); *id.* § 20(b), 15 U.S.C. § 77t(b) (injunction); Exchange Act § 15(b)(5)(D), 15 U.S.C. § 78o(b)(5)(D) (1964) (broker-dealer discipline for violation of 1933 or 1934 Act); *id.* § 15(c)(4), 15 U.S.C. § 78o(c)(4) (compliance order). For examples of SEC trading suspensions and injunction suits, see cases cited note 29 *supra*.

¹⁸⁰ *Crane Co. v. Westinghouse Air Brake Co.*, 419 F.2d 787 (2d Cir. 1969).

practice it is required in an exchange offer, usually in the form of high and low prices of both securities for calendar quarters over the past 2 or 3 years.

The antimanipulative provisions offer some protection that these crucial current and historical market data are not distorted.¹⁸¹ But the line between true supply-demand and manipulation is sometimes indistinct, and there is no absolute assurance to the investor in a given case that some manipulation has not occurred.

In an exchange offer, information on the offeror's (and its associates') purchases of the offered securities might be useful to the offerees (and to the enforcement authorities) in determining possible manipulation, but is not routinely required.

c. *Time for Decision* (2.723).— A cash offer (unless for all the securities of a class) must be open for at least 10 days.¹⁸² This gives most securityholders a reasonable time to make their investment decisions, to seek advice and to observe the trading market reaction. It may be insufficient for a number of holders, e.g., those who do not read the financial press, those whose mailing addresses have changed or to whom no mailing is made, and those traveling or otherwise out of touch.

Before the Williams Bill, cash offers could be made on a first-come-first-served basis, creating a stampede effect and inhibiting careful judgment by the target securityholder. Now all tenders in the first 10 days of the Offer Period must be taken up pro rata.¹⁸³

A further safeguard for the holder who tenders in a cash offer is the right to change his mind within the first 7 days of the Offer Period and to withdraw his tender.¹⁸⁴ This is too short to do much good, but it does in rare instances relieve a headlong action. After the statutory withdrawal period, the tender is irrevocable if the offer and transmittal letter so provide (as they inevitably do).

¹⁸¹ See *id.* (discussed in text accompanying note 115 *supra*). An offeror cannot buy target securities in the trading market after the offer is announced. See SEC Exchange Act Rule 10b-13, 17 C.F.R. § 240.10b-13 (1969), reprinted in 2 CCH FED. SEC. L. REP. ¶ 26,752, at 20,071-4. And there are the general provisions against manipulation in Exchange Act § 9, 15 U.S.C. § 78i (1964). See generally 3 L. LOSS, *supra* note 53, at 1541-70.

¹⁸² This is the effect of the pro rata period discussed in text accompanying note 183 *infra*.

¹⁸³ Exchange Act § 14(d)(6), 15 U.S.C. § 78n(d)(6) (Supp. IV, 1969). For a full discussion, see A. BROMBERG, *supra* note 2, §§ 6.3(530)-(534); Bromberg, *Tender Offers*, *supra* note 2, at 509-13.

¹⁸⁴ Exchange Act § 14(d)(5), 15 U.S.C. § 78n(d)(5) (Supp. IV, 1969). For a full discussion, see A. BROMBERG, *supra* note 2, §§ 6.3(520)-(524); Bromberg, *Tender Offers*, *supra* note 2, at 506-08.

But the offeree has another chance to change his mind 60 days after the start of the offer if his tender hasn't been taken up.¹⁸⁵

Exchange offers commonly have provisions like the ones just described for cash offers. They are not mandated by statute, although the Williams Bill¹⁸⁶ serves as a standard of fairness which the SEC staff reviewing an exchange offer registration can urge very forcefully.

d. *Improved Offer* (2.724).— If the offeror raises the ante during a cash offer, the Williams Bill requires that the higher price be paid to holders who tendered before the increase as well as to those who tendered after.¹⁸⁷ The increase also starts a new 10-day period of pro rata takeups.¹⁸⁸ There are no comparable statutory requirements for exchange offers, but the result is usually the same.

3. *Safeguards Against Discrimination* (2.730).— We have already noted under other headings several measures which operate also to prevent discrimination among offerees. They are conveniently recapitulated here:

- (1) Prohibitions on purchases by the offeror outside the offer, e.g., at a higher price.¹⁸⁹
- (2) Retroactive effect of a price increase during an offer.¹⁹⁰

¹⁸⁵ *Id.*

¹⁸⁶ See Exchange Act § 14(d)(5)-(7), 15 U.S.C. § 78n(d)(5)-(7) (Supp. IV, 1969).

¹⁸⁷ *Id.* § 14(d)(7), 15 U.S.C. § 78n(d)(7) (Supp. IV, 1969). For detailed discussion, see A. BROMBERG, *supra* note 2, §§ 6.3 (550-554); Bromberg, *Tender Offers*, *supra* note 2, at 513-15.

¹⁸⁸ Exchange Act § 14(d)(6), 15 U.S.C. § 78n(d)(6) (Supp. IV, 1969). For a detailed discussion, see A. BROMBERG, *supra* note 2, §§ 6.3(550)-(554); Bromberg, *Tender Offers*, *supra* note 2, at 513-15.

¹⁸⁹ SEC Exchange Act Rule 10b-13, 17 C.F.R. § 240.10b-13 (1969), *reprinted in* 2 CCH FED. SEC. L. REP. ¶ 26,752, at 20,071-4. There is apparently nothing to prevent an offeror from buying at a higher price before the offer is announced. See authorities cited note 40 *supra* & accompanying text. If it buys in the trading market, it is apt to run up the price at which it has to make the offer. But this will not necessarily be true if there is a considerable lapse of time, or if the prior purchases are outside the trading market. For example, Glen Alden bought a control block of Schenley Industries from the Rosenstiel interests in 1968 at \$80 per share and promised to make an equivalent tender offer to all holders. The offer when made, consisted of cash, debentures, and warrants. For allegations that it was worth less than \$80 per share and that there were misrepresentations, nondisclosures and other Rule 10b-5 violations, see *Kahan v. Rosenstiel*, [Current Binder] CCH FED. SEC. L. REP. ¶ 92,589, at 98,685 (3d Cir. Feb. 20, 1970), wherein the Third Circuit held that plaintiff had stated a cause of action for attorney's fees, claiming that the offer had been improved twice as a result of his efforts. Underlying this was a holding that plaintiff's original attack on the offer stated a cause of action even though he was not a buyer or seller of securities.

¹⁹⁰ Exchange Act § 14(d)(7), 15 U.S.C. § 78n(d)(7) (Supp. IV, 1969). For a dis-

(3) Pro rata takeups for first 10 days.¹⁹¹

(4) Disclosure of "arrangements" and "purposes and plans" which would include special benefits for target management.¹⁹²

Yet another antidiscrimination provision is the ban on short tendering. A person is barred from tendering pursuant to the offer more target securities than he owns.¹⁹³ It is no longer legal for more sophisticated and daring investors to try to beat the pro rata takeup requirements by tendering excess amounts of securities, or to take advantage of the offeror to this extent. They can, however, sell short in the trading market at a price that may approximate the offer price.

There are also the state law condemnations of sale of control at a premium,¹⁹⁴ which may occur in connection with a tender offer.¹⁹⁵

4. *Safeguards Against Target Management Self-Interest* (2.740).— We observed earlier that there may be a cleavage between the interests of target company management and those of the securityholders.¹⁹⁶ Management's own interest may lead it in either direction, *i.e.*, to oppose an offer which is beneficial to shareholders, or support one which is not. In the first case it is likely to be because management fears ouster, in the second because it has been promised continuity and perhaps increases in salaries, options and other benefits.

State law fiduciary principles are operative in this area, but with unpredictable effectiveness.¹⁹⁷ The theoretical standard is strict impartiality,¹⁹⁸ and devotion to the corporate-shareholder wel-

discussion, see A. BROMBERG, *supra* note 2, §§ 6.3(550)-(554); Bromberg, *Tender Offers*, *supra* note 2, at 513-15.

¹⁹¹ Exchange Act § 14(d) (6), 15 U.S.C. § 78n(d) (6) (Supp. IV, 1969). For a discussion, see A. BROMBERG, *supra* note 2, §§ 6.3(530)-(534); Bromberg, *Tender Offers*, *supra* note 2, at 509-13.

¹⁹² See text accompanying notes 174-75 *supra*. See also cases cited note 204 *infra*.

¹⁹³ SEC Exchange Act Rule 10b-4, 17 C.F.R. § 240.10b-4 (1964), *reprinted in* 2 CCH FED. SEC. L. REP. ¶ 26,742, at 20,061-2. See A. BROMBERG, *supra* note 2, § 6.3(660); Bromberg, *Tender Offers*, *supra* note 2, at 528-30.

¹⁹⁴ See, *e.g.*, *Perlman v. Feldmann*, 219 F.2d 173 (2d Cir. 1955); W. CARY, *supra* note 158, at 827-32. *But see* *Essex Universal Corp. v. Yates*, 305 F.2d 572 (2d Cir. 1962).

¹⁹⁵ See note 189 *supra*.

¹⁹⁶ Sec. (2.610) *supra*.

¹⁹⁷ See secs. (2.610), (2.630) *supra*.

¹⁹⁸ *Northwest Indus., Inc. v. B.F. Goodrich Co.*, 301 F. Supp. 706, 712-13 (N.D. Ill. 1969).

fare. But this is too much to expect with any consistency in the world of affairs, and we must usually settle for a good bit less.

Federal, and perhaps state, securities law requires disclosure of relevant facts. The offeror must reveal "arrangements" and "purposes and plans."¹⁹⁹ Target management must state the "reasons" for its recommendations.²⁰⁰ Such disclosure, honestly made, paves the way for enforcement of state law duties. Material misrepresentation or omission, if it can be detected, invokes the antifraud provisions and a wide variety of possible remedies. The bar on purchases by the offeror outside the offer may reinforce state law restrictions on special consideration to management.²⁰¹

If management tenders its own target securities, or sells them in the trading market, with knowledge of undisclosed material information about the company, it violates Rule 10b-5 and may be held to account.²⁰² Normally, this would be negative information about the target company, encouraging bailout before the news is public.²⁰³ Nondisclosure of information about a better offer for some or all of the target securities or of special benefits for management, may also violate Rule 10b-5.²⁰⁴ In the context of a tender offer, such actions would also violate section 14(e) of the 1934 Act.²⁰⁵

In a broader sense, the offer itself is a safeguard against target management self-interest or incompetence.²⁰⁶

¹⁹⁹ See cases cited note 51 & text accompanying notes 174-75, 192 *supra*.

²⁰⁰ Exchange Act § 14(d)(4), 15 U.S.C. § 78n(d)(4) (Supp. IV, 1969). See text accompanying note 114 *supra*.

²⁰¹ See cases cited note 194 *supra*.

²⁰² SEC v. Texas Gulf Sulphur Co., 401 F.2d 833 (2d Cir. 1968) (en banc), *cert. denied*, 394 U.S. 976 (1969), *injunction denied on remand*, [Current Binder] CCH FED. SEC. L. REP. ¶ 92,572, at 98,584 (S.D.N.Y. Feb. 6, 1970); *Astor v. Texas Gulf Sulphur Co.*, 306 F. Supp. 1333 (S.D.N.Y. 1969).

²⁰³ See *Diamond v. Oreamuno*, 24 N.Y.2d 494, 248 N.E.2d 910, 301 N.Y.S.2d 78 (1969).

²⁰⁴ SEC v. Skagit Valley Tel. Co., SEC Litigation Release Nos. 3390 (Dec. 9, 1965), 3393 (Dec. 21, 1965), 3483 (Apr. 8, 1966) (W.D. Wash. 1965-66), *discussed in* 32 SEC ANN. REP. 116 (1966) (\$394 thousand restitution to offerees from offeror, target company and its insiders); SEC v. Fruit of the Loom, Inc., SEC Litigation Release Nos. 1923 (Feb. 20, 1961), 1938 (Mar. 10, 1961) (S.D.N.Y. 1961), *discussed in* 27 SEC ANN. REP. 92-93 (1961); Fleischer & Mundheim, *supra* note 2, at 343-44. The disclosure required for change of board control without shareholder vote [Exchange Act § 14(f), 15 U.S.C. § 78n(f) (Supp. IV, 1969); SEC Exchange Act Rule 14f-1, 17 C.F.R. § 240.14f-1 (1969), *reprinted in* 2 CCH FED. SEC. L. REP. ¶ 26,888, at 20,153] may be a tipoff of special benefits to target company management.

²⁰⁵ Exchange Act § 14(e), 15 U.S.C. § 78n(e) (Supp. IV, 1969).

²⁰⁶ Manne, *Salute to "Raiders"*, *Barron's*, Oct. 23, 1967, at 1, col. 1, arguing also that tender offers benefit the economy as a whole. For an amplification of these arguments, see Manne, *Cash Tender Offers for Shares — A Reply to Chairman Cohen*, 1967 DUKE L.J. 231.

5. *Safeguards Against Third Party Recommendations* (2.750).— Statements from the offeror in support of the offer, and from the target company in support or opposition, are governed by disclosure requirements and antifraud rules already commented upon.²⁰⁷ Recommendations of third persons are subject to the antifraud provisions and, in the case of a cash offer, to substantive SEC rulemaking. To date all oral recommendations are exempted, and so are many written ones.²⁰⁸ The third persons most likely to be making recommendations are brokers. Motivated by the attractive commissions in the offer,²⁰⁹ and the possibility of another commission if the proceeds of a cash offer are reinvested through them, the brokers naturally tend to become advocates for the offer. Target securityholders are informed of the commissions in the offer and may thus be alerted to possible bias of brokers.

6. *Safeguards Against Success of the Offer* (2.760).— So far as the target securityholder feels threatened by the offer, he has several safeguards. He with enough of his fellow holders can defeat the offer by holding onto his securities. There are serious weaknesses in this safeguard. One is the difficulty of collective action by numerous holders. Another is the perverse logic at work: the more threatening the offer seems, the more likely the holder is to help it succeed, either by tendering or by selling in the trading market to someone who is likely to tender. A third is the uncertainty about the prospects of the offeror as the offer proceeds. If a holder knew with any clarity what fellow holders were doing, he might be able to make better predictions about the success of the offer (*e.g.*, whether the minimum number of shares were likely to be tendered). He can follow the volume figures in the financial press if the target security is listed on an exchange. But he has no way of knowing what off-board transactions are adding to this volume. And he can rarely know where the selling is coming from and how much of it is reselling by purchasers taking a quick profit from the impetus of the offer.

All the devices available to the target company to defeat the offer which were discussed earlier²¹⁰ are relevant here. Target securityholders opposing an offer will usually be led by target com-

²⁰⁷ Sec. (2.721) *supra*.

²⁰⁸ For detailed discussion, see A. BROMBERG, *supra* note 2, § 6.3(650); Bromberg, *Tender Offers*, *supra* note 2, at 527-28.

²⁰⁹ See secs. (1.220), (2.130) *supra*.

²¹⁰ Secs. (1.500), (2.520) *supra*.

pany management with similar views.²¹¹ Indeed, target company management probably has a duty to oppose an offer which is detrimental to the company or its shareholders.²¹²

A target company securityholder, whether or not he tenders, probably has standing to sue for violation of various antifraud and disclosure clauses of federal securities laws.²¹³

7. *Safeguards Against Assumption of Control and Against Economic Injury* (2.770).— The techniques to keep the offeror from taking control are principally the ones described earlier in connection with the target company's viewpoint.²¹⁴ Many of them call for securityholder approval. Moreover, there is yet another disclosure requirement of the Williams Bill applicable to a change of control of the board of directors by arrangement or understanding (*e.g.*, with target company management) without a shareholder vote. Information on the newcomers, equivalent to that in a proxy statement for their election as directors must be sent to shareholders 10 days in advance.²¹⁵

The protections against economic injury are essentially the same as for the target company.²¹⁶ Cooperation of securityholders may be needed to implement them.

8. *Safeguards Through the Legal Profession* (2.780).— It will be a rare securityholder who will take the time, trouble and expense to press his legal rights, for example, against the offeror or the target company management. His interest is simply too small. The devices which may make it feasible for him to do so (apart from subsidy by the offeror or target company) are the class action and the derivative suit. These, in turn, are largely energized by the possibility that attorneys for the securityholder will get court-awarded fees based on the benefits procured for the entire group of securityholders or for the corporation.²¹⁷ Like it or not, these must be recognized as necessary to make effective the security-

²¹¹ See sec. (2.610) *supra*.

²¹² *Northwest Indus., Inc. v. B.F. Goodrich Co.*, 301 F. Supp. 706, 712 (N.D. Ill. 1969).

²¹³ See note 189 *supra*.

²¹⁴ Sec. (2.530) *supra*.

²¹⁵ Exchange Act § 14(f), 15 U.S.C. § 78n(f) (Supp. IV, 1969); SEC Exchange Act Rule 14f-1, 17 C.F.R. § 240.14f-1 (1969), *reprinted in* 2 CCH FED. SEC. L. REP. J 26,888, at 20,153.

²¹⁶ See sec. (2.540) *supra*.

²¹⁷ See A. BROMBERG, *supra* note 2, § 9.3.

holders' safeguards.²¹⁸ The courts seem increasingly to acknowledge this as they liberalize the right to recover fees.²¹⁹

9. *Critique* (2.790).— The target securityholder, like the target company and its management, seems more than adequately protected against the success of the offer. But he is something less than adequately assured a chance to accept the offer. The management of his own company may keep him from knowing of it by refusing the mailing list to the tender offeror. A well-balanced set of protections would assure him a copy of the offer, by requiring the target company to transmit the offer at the offeror's expense, or to furnish the mailing list in quickly usable form to the offeror.²²⁰ The offeror might spurn the mailing, because of the expense involved. Since a major claim of the tender offer is its nondiscriminatory character, a mandatory mailing may be in order, perhaps including air mail or telegraph to more remote holders if the pro rata period is as short as the minimum statutory 10 days.²²¹

Nothing in this suggestion need spoil the chance of a cash offeror to make a surprise offer. Although advance notice would benefit the target company and its management, and perhaps the target securityholders, it is probably out-weighted by the additional price the offeror would almost certainly have to pay. The demand for mailing or furnishing a list could be made on publication of the offer, and complied with in relatively few days.

Although market-information data on target securities is readily available in most situations, it would be appropriate to insist that the cash offeror include this (say by quarterly price ranges) in the offer. (The SEC as a matter of practice usually requires this in an exchange offer.) The burden of compliance would be negligible and the information might be valuable to the holder's investment decision.

²¹⁸ Parallel, but not necessarily equivalent, enforcement may come from the SEC, the state securities administrators, the target company or the offeror.

²¹⁹ See *Mills v. Electric Auto-Lite Co.*, [Current Binder] CCH FED. SEC. L. REP. § 92,556, at 98,532 (U.S. Jan. 20, 1970) (for violation of proxy rules); *Kahan v. Rosenthal*, [Current Binder] CCH FED. SEC. L. REP. § 92,589, at 98,685 (3d Cir. Feb. 20, 1970).

²²⁰ By virtue of SEC Exchange Act Rule 14a-7, 17 C.F.R. § 240.14a-7 (1969), reprinted in 2 CCH FED. SEC. L. REP. § 26,861, at 20,116, an opposition proxy solicitor is given these alternatives. Management has the option of which to furnish. A requirement of this sort in the tender offer context would obviously help the offeror as well, but the securityholder's interest justifies it. See sec. (2.150) *supra*.

²²¹ N.Y. STOCK EXCH. CO. MANUAL A-180 (1963), and AMERICAN STOCK EXCH. CO. GUIDE § 904 (1968), provide for airmail or telegrams, and for telegraphic tenders through banks or brokers.

A strong argument can be made that target securityholders are entitled to a recommendation from their management. Nothing like this is now required, although there is sure to be a recommendation if management is opposed. Despite its self-interest, management is probably in a better position than anyone else to evaluate the offer and to disclose any information on the target company, such as current accomplishments, projects or earnings, which might materially affect the value of the target securities.²²²

While the pro rata acceptance of early tenders has appealing elements of fairness, it often leaves the small shareholder with tag ends returned to him, maybe 27 shares out of 100. Requiring or permitting small tenders (say 100 shares or less) to be accepted in full might be fairer, and would certainly be more convenient to the small holder.²²³

There have been suggestions to prohibit the broker's extra commission which tends to bias his recommendations in favor of the offer.²²⁴ In my judgment, disclosure is a sufficient protector here, as it is in underwritten sales of securities, where masses of account executives are similarly mobilized by special compensation.

In the aftermath of the offer, the minority holders of target securities — those who did not tender or sell, and those whose tenders were not taken up — face the possibility of squeezeout. The form may be merger into the offeror or one of its subsidiaries, or sale of assets to any of them, followed by dissolution.²²⁵ There is some inequity in forcing a securityholder to give up his investment, and perhaps pay a tax, after he has chosen not to tender. However, it is not clear to me that his status should be protected at the expense of majority voting rights. On the other hand, it is

²²² See Fleischer & Mundheim, *supra* note 2, at 349 & authorities cited therein.

²²³ There would have to be some mechanism to prevent the one thousand-shareholder from submitting 10 tenders of 100 shares each to take unfair advantage of the minimum round lot.

²²⁴ See, e.g., PLI CORPORATE LAW & PRACTICE TRANSCRIPT, TEXAS GULF SULPHUR — INSIDER DISCLOSURE PROBLEMS 490-500 (Series No. 1, 1968) (A. Fleischer & J. Flom eds.) (comments of W. McNeil Kennedy).

²²⁵ For the range of squeezeout techniques, see F. O'NEAL & J. DERWIN, EXPULSION OR OPPRESSION OF BUSINESS ASSOCIATES 41-98 (1961). For examples in which causes of action were stated under SEC Exchange Act Rule 10b-5, 17 C.F.R. § 240.10b-5 (1969), see *Vine v. Beneficial Fin. Co.*, 374 F.2d 627 (2d Cir. 1967), *cert. denied*, 389 U.S. 970 (1967); *Voegel v. American Sumatra Tobacco Co.*, 241 F. Supp. 369 (D. Del. 1965). For an appraisal proceeding on the same facts, see *Poole v. N.V. Deli Maatschappij*, 243 A.2d 67 (Del. 1968) (prior opinion, 224 A.2d 260 (Del. 1966)), *motion to reopen denied*, 257 A.2d 241 (Del. Ch. 1969) (value not proved to be higher than amount offered in tender offer and in squeezeout merger).

clear that he should be entitled to fair consideration if he is squeezed out. Most states try to assure this by providing appraisal rights which he may invoke if he is dissatisfied with the consideration offered in the squeezeout transaction.²²⁶ But sometimes the appraisal right is denied in a sale of assets even though it is granted for a merger.²²⁷ The appraisal right is not always protective in practice. Time limits may be too short for many shareholders, and there are technicalities and pitfalls along the road. The final valuation is unpredictable. A better procedure is probably needed, although as much in ordinary mergers as for those following tender offers. Despite the flaws of appraisal, it does seem unconscionable to bar it in asset sales. And in any case, if a squeezeout occurs shortly after a tender offer, say within a year, the price should be no less than that paid in the offer.

I. *Other Target Company Securityholders* (2.800)

1. *Interests* (2.810).— Holders of target company securities not bid for in the offer (*e.g.*, nonconvertible preferred stock and debt, or nonvoting common) are nonetheless potentially affected by it, for example, through possible changes in the financial condition of the company, imperilling their dividend or interest payments. On the other hand, their protective covenants may be strong enough to assuage any concern.

Holders of securities convertible into a common being bid for — if the convertible is not itself being bid for — have a more immediate problem. They have roughly the same alternatives as holders of target securities. But, in order to tender, they must convert and sacrifice their senior position (and perhaps higher yield) in the event the tender is not taken up. Holders of warrants to purchase target common stock are in a similar position, although they sacrifice leverage (rather than seniority and income) in order to be in a position to tender.

2. *Safeguards* (2.820).— The safeguards of these securityholders include resort to the market to sell their securities, although the market is unlikely to be favorable if it shares their judgment that the offer is a threat to them. But the market should itself be at least short run favorable for some securityholders — those with

²²⁶ *E.g.*, ABA-ALI MODEL BUS. CORP. ACT §§ 73, 74 (1967).

²²⁷ Compare DEL. CODE ANN. tit. 8, § 262 (1953), *as amended*, (Supp. 1968), *with id.* § 271. See *Hariton v. Arco Electronics, Inc.*, 40 Del. Ch. 326, 182 A.2d 22 (Ch. 1962), *aff'd*, 41 Del. Ch. 74, 188 A.2d 123 (Sup. Ct. 1963).

warrants to buy target securities or with senior issues convertible into target securities — because the trading market prices for their securities should reflect the premium in the offer itself.

Securityholders may have contractual protections in charters or indentures, which will minimize injury from the offeror if it takes control. These often take the form of minimum surplus requirements for dividends or indenture approval for borrowings above a certain level.

State law obligations of due care in management, and prohibitions on self-dealing give some additional protection to securityholders. At best, however, these are likely to be enforceable by stockholders but not by debt holders, since only the former normally have capacity to sue for breach of a duty to the corporation.²²⁸ Corporate duties may be enforced by creditors in extreme instances, when a receiver or bankruptcy trustee is appointed, or perhaps by means of a creditors' bill.

The disclosure requirements described earlier²²⁹ are ostensibly beamed at target securityholders. But they convey information helpful to other securityholders in their judgments. Probably the most important is the statement of the offeror's purposes and plans for the target company.

It is unlikely that these securityholders have any standing to sue for violation of the securities laws. They seem to be outside the zone of intended protection. If their vote is later sought for charter amendment, merger, indenture revision or other action, they have the safeguard of their voting power, of the proxy rules (if applicable), and of standing to sue for violations in the solicitation.

3. *Restraints* (2.830).— There are no special restraints for this group of securityholders.

4. *Critique* (2.840).— Holders of target company securities not sought in a tender offer are largely unprotected by the securities laws from injury through a tender offer. They have moderate protections in state law, but these turn heavily on their particular charter or contract rights. Since these holders are not directly involved in the offer, it is not at all certain that they need greater protections than they now have.

²²⁸ See *Sutton v. Reagan & Gee*, 405 S.W.2d 828 (Tex. Ct. Civ. App. 1966); R. BAKER & W. CARY, *CASES AND MATERIALS ON CORPORATIONS* 619-22 (3d ed. unabridg. 1959).

²²⁹ Sec. (2.721) *supra*.

J. *Target Company Constituents* (2.900)

1. *Interests* (2.910).— The constituents of the target company may have interests analogous to those of comparable bodies in the offeror described earlier.²³⁰ Employees are often worried about less generous wage scales or benefits paid by the offeror. Employee profit sharing or pension trusts may come under the control of the offeror and suffer a change in investment policy or diversion of assets. Local communities where the target company has plants may be apprehensive that the plants will be run from a distant headquarters heedless of local problems or, worse yet, closed down entirely with loss of jobs, income, taxes and property values. There may be similar apprehension that corporate headquarters which is a local ornament, will be moved to another city.

2. *Safeguards* (2.920).— The available safeguards appear to be like those for constituents of the offeror, described earlier.²³¹ Community pressures may manifest themselves in effective ways.²³²

3. *Restraints* (2.930).— There are no special restraints on the members of these groups, as such, relative to a tender offer.

4. *Critique* (2.940).— The comments made earlier in the discussion of offeror constituents are applicable here.²³³

K. *Third Persons and the Market* (2.1000)

1. *Interests* (2.1010).— Persons unrelated to either company may have an interest in the offer (and its outcome) through the trading markets. These include prospective purchasers of securi-

²³⁰ Sec. (2.410) *supra*.

²³¹ Sec. (2.420) *supra*.

²³² See, e.g., the promises of IT&T in the Hartford Fire acquisition, described in note 8 *supra* (obviously made in response to some felt need and pressure, including opposition to the acquisition from local insurance agents); Wall Street Journal, Jan. 27, 1969, at 21, col. 3 (Southwest ed.) (union officials were urging the rejection of General Foods' offer to buy Rountree). See also *Bath Indus., Inc. v. Blot*, 305 F. Supp. 526 (E.D. Wis. 1969), wherein a group of big shareholders were enjoined from proceeding with plans to take control of the board of directors of their company. Their violation was failure to file pursuant to Exchange Act § 13(d), 15 U.S.C. § 78m(d) (Supp. IV, 1969), which is very similar to the filing requirement for a cash tender offeror. See Exchange Act § 14(d), 15 U.S.C. § 78n(d) (Supp. IV, 1969). Their principal objective was to change chief executives, but the court made quite a point of their intent to move the corporate headquarters from Milwaukee to New York. Judge Reynolds gave a clue to his feelings on matters of such local interest by taking judicial notice that Wisconsin is the most civilized state in the Union. 305 F. Supp. at 533 n.4. The case underlines the value to the target company of the broad venue provisions of Exchange Act § 27, 15 U.S.C. § 78aa (1964), which will often permit it to sue in its home district. See also the Jones & Laughlin union demands, and the vesppure, summarized in note 8 *supra*.

²³³ Sec. (2.440) *supra*.

ties of either company, whether for arbitrage, other speculation, or long-term investment. They include prospective sellers (other than existing securityholders who were considered earlier);²³⁴ these persons think the securities are overpriced and hope to make a profit on selling short. Still different persons — certain arbitrageurs — are prospective buyers of target securities and concurrent short sellers of the offeror's securities. Also interested are brokers who, as noted above,²³⁵ may earn a double commission on tenders and perhaps more.

Possible concerns of the market relate to the effect on other securities (*e.g.*, in the same industries, or related companies) of the price fluctuations of the securities of the offeror and the target company, or on the availability of credit for market transactions. There is an effect on the value of existing portfolios containing securities of the offeror or the target company and, at least in the case of open-end investment companies, on the prices at which their own shares buy and sell, and on their performance records.

The specific interests of these various persons are quite divergent. Their common concern should be that the trading market is free from manipulation, that it has enough information to avoid unnecessary bias²³⁶ and that there are no more impediments to the smooth functioning of the market than are absolutely necessary to protect other interests.

2. *Safeguards* (2.1020).— At least in the common interest just postulated, the chief safeguards for third persons are the disclosure, antifraud and antimanipulation provisions of the securities laws. Nonetheless, it is an open question whether any but actual buyers and sellers have standing to sue for violations.

Momentary trading halts by the stock exchanges when a tender offer is announced have some protective effect.²³⁷

3. *Restraints* (2.1030).— There are no restraints in this area that are peculiar to tender offers, other than the prohibition on short tendering.²³⁸ Persons in this group are governed by general

²³⁴ Secs. (2.300), (2.700), (2.800).

²³⁵ Secs. (1.220), (2.130) & text accompanying note 209 *supra*.

²³⁶ *Cf.* SEC v. Texas Gulf Sulphur Co., 401 F.2d 833, 848, 851-52 (2d Cir. 1968) (*en banc*), *cert. denied*, 394 U.S. 976 (1969) (trading market investors should have equal access to material information and to the rewards of market transactions).

²³⁷ See sec. (1.320) *supra*.

²³⁸ See text accompanying note 193 *supra*.

market restraints, such as margin limitations on purchases²³⁹ and prohibitions on down-tick short sales.²⁴⁰

4. *Critique* (2.1040).— I see no glaring gaps in protection for the trading market. Perhaps there should be a brief trading halt when a previously unannounced offer is made for an over-the-counter target security. In all offers, there is a need for prompt announcement in the Post-Offer Period of how many tenders, if any, will be taken up, so that future trading may take this into account. Because of the difficulty in tallying tenders, no fixed deadline for publicizing the results would be feasible. An argument could be advanced for periodic statements, during the Offer Period, of the number of tenders received. The slow mechanics of tallying might make this information unreliable or stale when released. And it could be misleading if, as seems true in most cases, tenders concentrate at the end of the Offer Period or of the interval for pro rata takeups.²⁴¹

III. CONCLUSIONS — WHAT TO DO ABOUT TENDER OFFERS

A. *Introduction* (3.100)

We have looked at the tender offer from the vantage points of the diverse groups that may be affected by it. To gain a different and more summary perspective, we will draw conclusions from other lines of view which intersect those already considered:

- (1) Competition and Public Interest.
- (2) Investor Protection .
- (3) Corporate Integrity (an admittedly vague phrase).

Under each of these, we will inquire whether the tender offer should be outlawed, regulated, modified or left as is. In most instances it will be helpful to distinguish between the offer itself, and its possible consequences.²⁴²

B. *The Good and the Bad* (3.200)

A tender offer may turn out well for everyone. It may be smoothly negotiated and supported by target management. The price may attract the desired securities. The trading market level of

²³⁹ Exchange Act § 7, 15 U.S.C. § 78g (Supp. IV, 1969).

²⁴⁰ SEC Exchange Act Rule 10a-1, 17 C.F.R. § 240.10a-1 (1969), *reprinted in* 2 CCH FED. SEC. L. REP. ¶ 26,733, at 20,059.

²⁴¹ See text accompanying note 6 *supra*.

²⁴² For a list of the possible consequences, see sec. (1.400) *supra*.

the untendered securities, and of the offeror's securities, may rise. A harmonious and profitable business relation between the two companies may ensue, with benefits for employees and other constituents, and without injury to competition in the economy.

Or, the offer may turn out badly for everyone. The target management may be alienated. The price may be too high, attracting tenders, but paid in the form of dubious securities, which later decline in value. Securities not tendered also drop. The two companies may engage in further expensive struggle over management and policies, or (when management is changed) be operationally incompatible, with loss of business and morale.

Most of the time, of course, a tender offer will not be all good or all bad, but a mixture. Very often, perhaps most of the time, it will be impossible to tell in advance how it will turn out.

C. *The Central Issue* (3.300)

The tender offer has many aspects, as we have seen. The one that emerges as most important is that the tender offer is a market technique — as distinct from a corporate procedure of resolutions and votes — for acquiring control through securities purchases and for combining businesses. If this is carried out with the concurrence of target management, the result is similar to other acquisition techniques and presents no unusual issues. It is the fact that it can be done over the heads of target management that raises the difficult questions. Our problem then is to examine a market device which is capable of consolidating control through share ownership (usually from noncontrolling scraps) and leading to internal business changes without the consent, and maybe even over the opposition, of the officers and directors of the target company.

D. *Competition and Public Interest* (3.400)

I have already disclaimed expertise in the antitrust field.²⁴³ But I think it tolerably clear that the issue here is whether the tender offer is more of a threat to competition than other forms of combination. Or, to put it a bit differently, is an acquisition without target management acquiescence likely to be more anticompetitive than one with it? Perhaps the answer is yes, because of the ease and speed with which the acquisition may be accom-

²⁴³ Note 90 *supra*.

plished.²⁴⁴ Perhaps the answer is no, because of the greater likelihood that management would fight a competitor, even a tenuous one, than a neutral. But I think the answer is really unknown.

Without some clear evidence that tender offers are anticompetitive in a way that mergers are not, I see no justification for outlawing, regulating or modifying the tender offer. Whatever is necessary to satisfy antitrust policy should apply equally to mergers, tender offers and other forms of combination.

Many of the challenges to the tender offer have come from opponents of the conglomerates, who have been major users of the technique.²⁴⁵ Without attempting an evaluation of the conglomerate trend, I submit that the remedy, if one is needed, is a more comprehensive sweep of the antitrust laws rather than a curtailment of the tender offer.

Apart from competition and conglomeration, there are a number of other public interest factors in a tender offer, including those of employees, consumers and local communities. But their concerns are more with the possible consequences of a tender offer²⁴⁶ than with the offer itself, since any of the consequences might occur without a change of share ownership or management. Their concerns are not to be sneered at, and deserve to be heard. But they have ways to be heard now²⁴⁷ and do not merit a ban on tender offers (which may benefit these interests as often as they harm them). Nor do I think they call for some kind of governmental qualitative review of tender offers, unless we are willing to have the same review (a) for control changes by private purchase, market accumulation, merger or asset sale, and (b) for internal business changes by any of these means or by management alone. This would be a radical departure from private enterprise as we know it.

E. *Investor Protection* (3.500)

There are real problems for investors in tender offers, principally confusion,²⁴⁸ market turbulence, the need to make a relatively quick decision under some pressure, and the risk that another

²⁴⁴ Sometimes, perhaps, the possibility of acquisition without management acquiescence coerces management into acquiescence.

²⁴⁵ The anticonglomerate movement has taken many forms. See Hamilton, *Some Reflections on Cash Tender Offer Legislation*, 15 N.Y.L.F. 269, 270-71 (1969).

²⁴⁶ See sec. (1.400) *supra*.

²⁴⁷ See secs. (2.400), (2.900) *supra*.

²⁴⁸ See Kelly, *supra* note 34, at 628.

decision would have been more profitable.²⁴⁹ And there are rewards, notably the premium offered to target securityholders, and the stimulus to better performance by management of potential target companies. In other contexts federal law is wisely committed to a policy of investor choice, based upon relevant information. The same policy is valid here, and is adequately implemented by the Williams Bill for cash offers and the 1933 Act registration requirements for exchange offers. The former provides some guarantees against precipitate action, and against discrimination²⁵⁰ which are a departure from other securities laws, but which are worth keeping to see if they prove their apparent worth. States which essay qualitative review of securities sold within their borders can apply their standards to securities issued in exchange offers.²⁵¹ So may the stock exchanges.²⁵²

From the investor's corner, there is no reason to abolish the tender offer, and considerable reason to encourage it. Nor is there any good reason, in my judgment, to subject it to much further regulation. Several changes would improve investor protection:

(1) Compulsory mailing of the offer to all record holders of target securities.²⁵³

(2) Inclusion in a cash offer of historical and current market price data on target securities.²⁵⁴

(3) Full, rather than pro rata, takeup of small tenders.²⁵⁵

(4) Balancing the debate in a contested exchange offer by muzzling the target company or, preferably, unmuzzling the offeror.²⁵⁶

(5) Assurance that nontendering holders of target securities who are squeezed out shortly after the offer will receive no less than the offer price.²⁵⁷

(6) Early announcement of results of the offer.²⁵⁸

²⁴⁹ See secs. (2.710)-(2.713) *supra*.

²⁵⁰ See secs. (2.723), (2.730) *supra*.

²⁵¹ See the Ohio and Wisconsin authorities cited note 129 *supra*.

²⁵² See Wall Street Journal, Apr. 18, 1969, at 3, col. 1 (Eastern ed.) (N.Y. Stock Exch. refuses to list exchange offer debentures of General Host Corp. and NVF Co. because of insufficient pro forma earnings after debt charges).

²⁵³ See secs. (2.150), (2.790) *supra*.

²⁵⁴ See sec. (2.790) *supra*.

²⁵⁵ *Id.*

²⁵⁶ See sec. (2.150) *supra*.

²⁵⁷ See sec. (2.790) *supra*.

²⁵⁸ See sec. (2.1040) *supra*.

(7) Perhaps extension of the Williams Bill to target insurance companies.²⁵⁹

(8) Perhaps a required recommendation of target management to holders of target securities.²⁶⁰

F. *Corporate Integrity — The Offeror* (3.600)

I see a need for better protection of offeror securityholders against improvident tender offers. This is no reason to ban tender offers or to review them administratively. At the least, more disclosure to offeror securityholders is needed, including a prompt notice of the offer with pro forma statement of earnings per share in the event of success.²⁶¹ And there is something to be said for a kind of appraisal right (based on preannouncement values) for offeror securityholders, although the difficulties may outweigh the advantages.²⁶²

G. *Corporate Integrity — The Target Company* (3.700)

As a device for obtaining control of the target company, the tender offer has some distinct superiorities over other methods. It is nondiscriminatory, assuming that it is adequately communicated to all holders of target securities, with reasonable times for them to tender and be taken up pro rata. This eliminates the troublesome premium to a control group for its holdings. It is just the equal opportunity that critics have called for,²⁶³ with all holders having the right to share the premium proportionally.

The tender offer may be the solution to another classic problem: the separation of ownership and control. Berle and Means, the early observers and critics of this development in large corporations, distinguished (among others) private ownership, majority ownership, minority control and management control.²⁶⁴ The history of most publicly held corporations in the United States has been a progression in this direction, as a result of going public, growing in size, and reducing proportional holdings through additional financing and acquisitions. The trend is largely one-way. The de-

²⁵⁹ See sec. (2.550) *supra*.

²⁶⁰ See sec. (2.790) *supra*.

²⁶¹ See sec. (2.340) *supra*.

²⁶² *Id.*

²⁶³ See Andrews, *The Stockholder's Right to Equal Opportunity in the Sale of Shares*, 78 HARV. L. REV. 505 (1965).

²⁶⁴ A. BERLE & G. MEANS, *THE MODERN CORPORATION AND PRIVATE PROPERTY* 94 (1934).

vice most likely to reverse the trend is the tender offer. It is commonly made for a target company in which management holdings are small,²⁶⁵ and is virtually the only way to assemble from fragmented holdings a minority control block of securities or a majority block. Insofar as this adds legitimacy and reduces divergency between ownership and control, the tender offer is beneficent.²⁶⁶

In these two aspects — sharing of the control premium and possible rejoining of ownership and control — the tender offer provides integrity for the target company. In another sense, it deprives the target company of integrity by short circuiting its duly chosen management. But the management is chosen by the shareholders and can hardly have a higher claim than the new holder of those shares.

The undermining of target management by a tender offer is not a matter to be taken lightly. But it hardly justifies any sort of prohibition on the tender offer, or any sort of government review.²⁶⁷ Nor does it support any sort of requirement that tender offers be subject to veto by target management. This would turn a market action into a corporate procedure. It would give management a restriction on transfer of outstanding securities²⁶⁸ that is wholly unwarranted when holders want to sell. Further, it would nullify voting rights at the one point they are likely to be valuable to the small holder, *i.e.*, when someone is willing to buy his securities at a premium to get the vote.

Target management already has abundant weapons to fight a tender offer. The SEC filing requirements subject it to questionable delay in beginning the fight against a surprise offer. Advance filing is reasonable if the target company has advance notice. In other cases, while a little delay may encourage a cooler response,

²⁶⁵ See, *e.g.*, Vance, *Is Your Company a Take-Over Target?*, 47 HARV. BUS. REV. 93 (May-June 1969).

²⁶⁶ If the offeror is a company suffering from the same split of ownership and control, the problem has not been cured, merely shifted to another entity. But, at least, it exists in one place less than before.

²⁶⁷ A reasonable exception would be fiduciary institutions or regulated industries where the government already has some sort of review of management personnel, or some special interest in control changes. See, *e.g.*, 49 U.S.C.A. § 1378(a)(5) (Supp. 1970), amended in 1969 to require Civil Aeronautics Board approval of acquisition of control of an air carrier by any person. Previously, the provision applied only to control by another carrier or person engaged in aeronautics. Ten percent ownership is presumed to be control unless the Board finds otherwise.

²⁶⁸ Transferability of shares is a hallmark of the corporation. It has been legislated into virtual negotiability, first by the Uniform Stock Transfer Act, and more recently (and completely) by UCC § 8-105(1).

fairness favors letting target management move at once and file later.²⁶⁹

The legal test to distinguish management's personal interest from the securityholders' or corporate interest — and thus to enforce their fiduciary duties — is not very discriminating.²⁷⁰ A better, more relevant test is whether opposition moves are reasonably calculated to produce a higher market value for the securities.²⁷¹

H. *Summation* (3.800)

Some improvements suggested above can be made in the tender offer and still preserve its great virtues. Beyond this, further efforts to regulate — by qualitative standards, corporate procedures or administrative review — would strengthen the hands of target management, if only through deterrence and delay of offers.²⁷² But they would undermine other cherished arrangements which make the tender offer work: free transferability of securities, voting rights for securityholders, and a market economy.

²⁶⁹ See sec. (2.550) *supra*.

²⁷⁰ See cases cited note 106 *supra*.

²⁷¹ See sec. (2.560) *supra*.

²⁷² On the effectiveness of delay, see sec. (2.527) *supra*.